

Lessons from the trenches

A former CFIUS representative explains the realities of filing with the body. Applicants should treat the process like a confession, not a deposition

The Committee on Foreign Investment in the US (CFIUS) has been likened to a black box. M&A parties submit an application in accordance with regulations that ask for detailed information on items such as the nature of the transaction, business activities of the US target company and business of the foreign entity. The rules are intentionally ambiguous to afford regulators maximum discretion. If they can arrange a meeting, companies file after having spent some time with CFIUS staff at the Treasury Department discussing their transaction, explaining their business model, and asking for guidance about the process. Their presentation is met with polite attention from CFIUS staff, whose answers to questions are always carefully crafted and invariably preceded by the disclaimer that the Committee does not issue advisory opinions, so a definitive response will have to wait for the formal application. After filing, the applicants wait expectantly for CFIUS to produce requests for clarification, hoping that their transaction can be cleared within the initial 30-day initial review period or the succeeding 45-day investigation period. They seek to avoid having to revise the deal to comply with CFIUS-imposed mitigation terms, or worse, scuttling the deal because of an actual or threatened presidential veto.

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During my four years as the State Department's principal representative to CFIUS, I listened to more than a few companies – many of them world-renowned and most from countries with

strong ties to the US – bemoan the opacity of the CFIUS-approval process. How could the US hope to retain its ranking as the world's preeminent destination for foreign investment, they asked, with a regime as tortuous as CFIUS? The conversation was even more delicate with companies from countries such as China. Chinese purchasers believed the system was rigged against their investments, even as major Chinese purchases received the green light from CFIUS. After many of these meetings, however, I came to the conclusion that more often than not the strategy adopted by CFIUS applicants contributed to their troubles. And so, when asked for general advice by foreign acquirers of US companies – some of which the US government hoped to entice into investment through programmes such as the Commerce Department's "SelectUSA" – I would try to impress upon them three important lessons learned during my time on the Committee. First, treat your CFIUS filing like a confession, not a deposition. Second, it is much easier to help CFIUS make up its mind than to change it. Third, the clock is not your friend.

A CFIUS primer

CFIUS is composed of representatives from the Department of Treasury (Chair), Department of Justice, Department of Homeland Security, Department of Commerce, Department of Defense, Department of State, Department of Energy, Office of the US Trade Representative and Office of Science & Technology Policy.

The Office of Management and Budget and the Council of Economic Advisors may observe and, as appropriate, participate in the Committee's activities. CFIUS is charged with reviewing and

investigating 'covered transactions' that may pose a risk to national security. But not all transactions with foreign entities are covered transactions, being those that could result in foreign control (which is broadly defined and applied on a case-by-case basis) of entities engaged in interstate commerce in the US. Covered transactions include a wide range of mergers, acquisitions and takeovers. New or greenfield investments in the US are not covered transactions, although what quacks like a greenfield investment to project finance lawyers may not look like a greenfield project to CFIUS. The committee is only concerned with transactions that implicate national security. The national security impact standard was expanded in 2007 to include not only the traditional categories one associates with the concept, such as the defence industrial sector, but also critical infrastructure (including major energy assets) and critical technologies. However, even under this expanded standard, CFIUS does not consider economic or other concerns, as do some other nations. CFIUS must apply the same rules and clearance standards to all investors, regardless of their country of origin.

The number of CFIUS filings has steadily risen since 2009. The 2013 Annual Report to Congress, which included numbers from 2012, shows an increase of approximately 75% from 2009, with 114 notices filed in 2012. A total of 45 investigations were conducted, and 20 notices were withdrawn after the commencement of the investigation. There was one presidential decision in 2012 – President Obama's decision to block Chinese-owned Ralls Corporation's acquisition of wind farm projects in Oregon located in the vicinity of a naval weapons systems training facility. This marked the first time since 1990 that a president has blocked a transaction. CFIUS filings made by Chinese investors tend to gain the most media attention. But acquisitions by UK investors actually made up the largest number of CFIUS notices from 2010 to 2012, comprising 21% of all applications. Investors from China accounted for 12% of the notices during this period.

And now for some lessons learned from four years in the CFIUS trenches.

Treat filing like a confession

Litigation lawyers counsel their clients to precisely answer the question asked, and nothing more. Whether in a deposition or on the witness stand, the respondent is

normally better off answering the question asked in the most direct, succinct manner, and waiting for the follow-up to be posed before responding. While this may be good litigation practice, it can backfire in a CFIUS filing. In a case that took place after I left office, when CFIUS asked the parties to identify the industries of the target's largest clients, they merely listed the top areas in which the target operated. One of these was in the defence sector. Predictably, this led to a CFIUS demand that the target disclose the principal clients – by name, address and contact person – and the revenues obtained from each of them. The parties would have gained some goodwill with CFIUS by anticipating that the Committee would want more details once it learned that one of the target's major clients was a defence contractor.

UK investors comprised the largest number of CFIUS notices from 2010 to 2012

They also would have saved precious time in a process that already envisions a relatively short review period.

Approaching a CFIUS filing as a deposition will, at best, delay the proceedings and, at worst, raise suspicions about the applicant's truthfulness and good faith. Instead, when responding to a CFIUS question applicants should first ask themselves why it is being asked and try to answer the prospective follow-ups as well. The Committee may be posing the question to gain a broader understanding of the transaction, and providing technically – but limited – correct information will not meet its needs. CFIUS staff may also be trying to head off an objection they anticipate will be voiced by one of the agencies and look to the applicant to shortcut the issue before it arises. Or CFIUS may be exploring

potential mitigation measures, such as whether a business will remain viable if the parties are asked to restructure the deal to exclude a sensitive sector. In short, a litigator's intuition may not serve the parties well in a CFIUS process. In my time with the Committee, I never saw an applicant run into trouble by providing too much information.

It's harder to change opinion

I sometimes watched a CFIUS process run into obstacles because of the parties' inability to articulate, early on, a clear and consistent rationale for the transaction or a response to a CFIUS query. In our personal and business lives, we know that it is easier to shape someone's initial opinion than to change it, but this life lesson is even more important in a highly charged environment involving national security. In the CFIUS context, agencies reach positions after careful consideration by the staff and many clearances at various levels in the bureaucratic chain. At the State Department, for example, the

clearances needed before a CFIUS decision memo reached my desk sometimes approached a dozen offices. Unravelling an agency's determination may require someone to admit having reached the wrong conclusion, explain the reason for the change, and conduct yet another arduous clearance process. None of these will be career-advancing tasks for anyone in the organisation, and the agency may not have the time or inclination to engage in such an exercise. This is another reason for answering the question, and the foreseeable follow-on questions, the first time.

The clock is not your friend

In sports, the team in the lead will often hold the ball and run out the clock. In CFIUS, however, applicants should always act as if playing catch up.

By statute, CFIUS conducts its review following an expedited timeline. There is a 30-day initial review, followed by an additional 45-day investigation period which is mandatory for covered transactions involving foreign-government controlled entities. Time periods are not extendable or waivable, and as a result, it is of utmost importance to be timely. Indeed, in recent years there have been several instances of companies needing to withdraw and re-file simply because the process has not been completed at the end of the 45-day investigation. At times this has been attributable to CFIUS's workload, but often the last minute rush is due to parties taking as much as a week to respond to CFIUS's questions, or doing so in a manner that requires a second and even a third prodding to resolve the concern. In the example involving the defence contractor, the parties would have avoided needlessly running out the clock had they answered the question in full the first time. In my years with CFIUS, I saw companies leave themselves no choice but to withdraw and refile by providing late or incomplete responses throughout the process. Sometimes they even acted as if they believed that CFIUS would be forced to approve their transaction if the Committee had its back against the wall.

Final word

A CFIUS filing is not a straightforward process. Although governed by federal regulations and involving lawyers, it is more art than science. But following a few unwritten rules, some of which might be counterintuitive, will help applicants emerge successfully from the black box.

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