

A Guide to Demystify the CFIUS Process

PRESENTED BY BAKER BOTTS



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OVERVIEW

Chinese companies have become increasingly active in investing and acquiring businesses and assets overseas in order to satisfy the ever-rising demand in China. The United States, being the world's largest economy with well-known companies, abundant natural resources and technologically advanced infrastructure, has been a key target for Chinese outbound investments.

Some Chinese companies have had difficulties in obtaining approval for their proposed investment or acquisition in the U.S. from the Committee on Foreign Investment in the United States ("**CFIUS**") while others have proven to be successful in obtaining such approval. The *Guide To Demystify The CFIUS Process* ("**Guide**") provides an overview of (i) the regulatory role and function of CFIUS, (ii) the scope and steps involved in the CFIUS review process, and (iii) some practical information and advices in relation to the CFIUS review process.

CFIUS is an inter-agency committee of the U.S. government that is authorized to review, investigate and block any transaction or investment that could result in the control of any U.S. businesses or assets by a foreign person that may raise national security concerns, or involve critical infrastructure. CFIUS is made up of representatives from nine federal agencies, including the Department of Defense, the Department of State and the Department of Homeland Security.

The Guide was prepared by the U.S. law firm, Baker Botts L.L.P., in collaboration with various members of the U.S.-China Energy Cooperation Program ("**ECP**"). ECP is a non-profit and non-governmental organization sponsored by, and with capital contributions from, various enterprises, and it focuses on the sustainable commercial development of clean energy and energy-efficient industries in China and the U.S. As a platform for government enterprises, ECP works closely with the U.S. and Chinese governments, and is officially recognized by both governments. Through the abundant technologies, products and commercial resources of its member companies, ECP pushes forward the development of commercially viable projects for clean energy and energy efficiency both in China and the U.S. and promotes the sustainable development of the energy industry in both countries.

We trust that you will find the Guide to be a useful tool in your planning and execution of acquisition or investment in businesses or assets in the United States. The aim of the Guide is to provide you with a better understanding of CFIUS and the procedures that are involved in its review process of foreign investments in the U.S. It is very much an introduction to the subject and is not intended to be a comprehensive guide to all issues relating to the CFIUS review process.

EXECUTIVE SUMMARY

CFIUS has authority to initiate review of almost any foreign investment in a U.S. company or asset that may have an impact on national security. It is not a mandatory requirement for the parties involved in such investment to file a notice for review by CFIUS. However, if such a notification is not filed, and subsequently CFIUS determines that the transaction raises U.S. national security or critical infrastructure concerns, then CFIUS has the authority to unwind the transaction. Such action by CFIUS is not subject to review by a U.S. court.

During the CFIUS review process, CFIUS will firstly determine whether the foreign investment is a "covered" transaction (i.e. does the completion of the transaction result in foreign control of any person engaged in interstate commerce in the United States).

If so, CFIUS will then consider whether the transaction raises potential U.S. national security or critical infrastructure implications.

If CFIUS determines that the transaction creates a risk to U.S. national security or critical infrastructure, then it may block the transaction or request the parties to take certain steps to mitigate such risk (e.g. restructure the transaction so that the foreign party does not have control over certain asset or business that CFIUS does not want it to have control over).

Further details regarding the steps and timing involved in the CFIUS review process, and some of the mitigating measures that the parties can adopt to obtain CFIUS approval, are set out in the Guide.

BRIEF INTRODUCTION OF THE AUTHOR - BAKER BOTTS L.L.P.

Baker Botts L.L.P. is very honored to be a member of ECP. We are pleased to provide this summary guide to the CFIUS process which we trust will be helpful to Chinese and foreign companies in their investment and acquisition of U.S. businesses and assets.

Baker Botts L.L.P. was founded in Houston in 1840 and for more than 170 years, Baker Botts L.L.P. has been among the leading law firms in the world. Today, with 700 lawyers based around the world, the firm ranks among the largest global law firms in scope and influence. Our clients include public and private companies, including those involved in all segments of the corporate and energy industries. This includes the representation of Chinese companies (including state-owned entities), governmental agencies, project companies, banks, insurance companies, investment firms, non-profit organizations, individuals, estates, and partnerships.

Baker Botts L.L.P. maintains offices in fifteen locations around the world: Abu Dhabi, Austin, Beijing, Brussels, Dallas, Dubai, Hong Kong, Houston, London, Moscow, New York, Palo Alto, Rio de Janeiro, Riyadh, and Washington. Baker Botts L.L.P. is widely regarded as among the top law firms in the world for representations involving Chinese companies in their investment and acquisition of businesses and assets in the U.S.

Baker Botts L.L.P. has substantial experience representing clients, including leading global information and telecommunication companies, mining companies, E&P companies, and oil refining and petrochemical companies, in transactions subject to CFIUS review. The CFIUS process has experienced several reforms in recent years, and knowledge of the background against which government agencies evaluate security issues and concerns is important to international mergers and acquisitions. The *America's Best Corporate Law Firms 2013* has recognized Baker Botts L.L.P. as one of the top law firms and the *U.S. News & World Report Best Law firms 2013* has recognized Baker Botts L.L.P. as a law firm with strong expertise and experience in Corporate Law (Tier 1), and International Trade and Finance Law (Tier 2). Chambers USA 2013 ranked Baker Botts Band 1 for Corporate/M&A with sources saying, "*The firm has a strong group of lawyers in every practice area relevant to our business, and they are very responsive to our requests for assistance.*"

Baker Botts L.L.P. is pleased to have assisted our clients in obtaining CFIUS approvals in a number of landmark transactions.

INTRODUCTION TO CFIUS

The United States has taken increasingly more expansive steps since 1975 to regulate foreign direct investment (“**FDI**”) through a process administered by CFIUS. CFIUS’ original general mandate, to review and in certain cases, block foreign companies from certain acquisition – has remained relatively constant. CFIUS’ powers and responsibilities, however, have grown tremendously since it was first established.

- In 1988, concerns over the pace of Japanese FDI led the U.S. Congress to pass the Exon-Florio provision of Omnibus Trade and Competitive Act of 1988.
- The Exon-Florio provision granted the President the authority to suspend or prohibit any foreign acquisition, merger or takeover of a U.S. business where the transaction was determined to threaten the national security of the United States.
- In 1992, Exon-Florio was amended to require an investigation of any merger, acquisition or takeover by companies controlled by a foreign government which could affect the national security of the United States.

CFIUS MATURES TO ITS CURRENT FORM

In 2007, CFIUS’ mandate was expanded significantly with the Foreign Investment and National Security Act of 2007 (“**FINSA**”). FINSA was the end result of a heated public and congressional debate over a 2005 acquisition involving the UAE state-owned company Dubai Port World.

- The acquisition by Dubai Port World, which had been approved in advance by CFIUS, was canceled by the company after it decided that the political controversy had escalated beyond containment – this decision is a precedent that remains a deterrent for many foreign acquirers considering sensitive market sector acquisitions.
- To some extent, FINSA must be viewed in the context of the Executive’s effort to restrain and contain strong Congressional motivations to become directly involved in FDI decisions, a prospect that most of the private sector and foreign companies view as potentially disastrous. FINSA therefore aimed to strike a compromise of providing more information to Congress, while at the same time insulating the decisions from political pressures.

FINSA was also instrumental in effectively regularizing and cleaning up the CFIUS process, which had developed in an ad hoc manner. In important respects, FINSA broadened the range of economic sectors that CFIUS is charged to protect.

- The CFIUS process is now formally chaired by the Department of Treasury, and includes a broader representation of official U.S. agencies.
- The U.S. Intelligence Community – through the Director of National Intelligence – serves as ex officio member and is required to provide an intelligence assessment to CFIUS for review.
- The Secretary of Labor was also added as an ex officio member.
- In total, CFIUS is comprised of 9 agencies, two ex officio representatives and other members as appointed by the U.S. President representing major departments and agencies within the U.S. federal executive branch. In addition to Treasury, the U.S. Departments of Energy, Commerce, State, Homeland Security, Justice, Trade, Science and Technology Policy and Defense are represented.

CFIUS STAFF

As stipulated in FINSA, the key decision makers in the responsible CFIUS agencies are political appointees, not career employees. However, the staff of the CFIUS are career civil servants who are mandated to perform their duties and executing the CFIUS review process in a manner that is independent from political agendas. As such, CFIUS strongly maintains that it does not have a policy of singling out particular nationalities for higher scrutiny.

PRACTICE POINTER:

The CFIUS process can become an inherently political process, a situation that places most foreign companies at a tremendous disadvantage. Certain types of transactions and certain companies and nationalities require a very different approach to CFIUS prior to an acquisition to assess the political ramifications and to implement plans to address issues such as public relations, domestic political controversies, and labor matters.

CFIUS' Nearly Limitless Jurisdiction

Today, CFIUS has jurisdiction to review almost any foreign investment transaction that may have an impact on national security.

- Only so-called “greenfield” investments – where no existing business is being acquired, are outside of CFIUS’ scope.

All other transactions – regardless of the nationality of the acquirer or the type of business – must be analyzed at least at a superficial level through the analytical structure that FINSA lays out to describe CFIUS’ jurisdiction.

Determining Whether Your Transaction is “Covered”

The first and most critical step of the analysis involves a technical term used by CFIUS, whether a particular foreign investment deal is a “covered transaction”.

- Under FINSA, CFIUS must review a “covered” foreign investment transaction which it determines may have an impact on the national security of the United States or where the acquiring entity is controlled by a foreign government.
- A “covered” foreign investment transaction refers to any merger, acquisition or takeover which results in foreign control of any person engaged in interstate commerce in the United States.

To arrive at a conclusion as to whether a transaction is covered requires analyzing the extent to which the foreign person will acquire “control” of a U.S. business.

- FINSA defines control as the power to determine, direct or decide matters affecting an entity including, but not limited to (i) the sale, lease, pledge or other transfer to the company’s assets, (ii) the dissolution of the company, or (iii) the closing or relocating of research and development facilities.
- Unfortunately, FINSA provides a very broad view of how “control” can be acquired, including through the ownership of a majority or dominant minority of the total outstanding voting securities, proxy voting or contractual arrangements.

National Security Impact

Once a determination is reached that a transaction is, or may be covered, the second key element of the CFIUS analysis is whether the transaction implicates any impact on the national security of the United States.

FINSA does not define “national security” – which is not atypical, as the U.S. Government consistently seeks to maintain maximum discretion for itself in defining defense and national security jurisdiction. FINSA did, however, broaden the scope of issues that fall under the national security category, and these now include a range of concerns that fall under homeland security, including all elements of critical infrastructure of the United States, a defined term that is notable to its breadth.

- “Critical infrastructure” is defined as “a system or asset, whether physical or virtual, so vital to the United States that the incapacity or destruction of the particular system or asset . . . would have a debilitating impact on national security.”
- Thus, a transaction that results in foreign control over major energy facilities, assets or other critical infrastructure (e.g., power plants, power transmission infrastructure or distribution networks) in the United States, will almost certainly give rise to national security concerns and be subject to review by CFIUS.

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Many greenfield type investments – as a business might define these, may nevertheless trip CFIUS jurisdiction, where for example, the acquisition involves land but also rights to certain economic activities.

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Given the many permutations of corporate structures, investor controls, particularly minority protections, the question of control can be complicated to resolve definitively, and parties often proceed to submit a transaction to CFIUS where they perceive their particular transaction falls within a grey zone.

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The breadth of the concept of “national security” include concerns over espionage – including a problematic concept that CFIUS refers to as “persistent collocation”, where a foreign company acquires a property close to a sensitive U.S. Government facility.

FINSA requires CFIUS to consider the impact of a covered foreign investment transaction on U.S. critical technologies.

- “Critical technologies” include (a) defense items, specifically items controlled under the International Traffic in Arms Regulations; (b) export controlled and dual use items controlled under the Export Administration Regulations for national security, chemical and biological weapons proliferation, nuclear proliferation or missile proliferation reasons; (c) items controlled under the Export and Import of Nuclear Equipment and Materials Regulations, and (d) items controlled under the Export and Import of Select Agents and Toxins Regulations (threats to plant, animal or human health).

CFIUS REVIEW PROCESS: ROUTINE REVIEWS

CFIUS has the mandate to be able to review and take action—including requiring unwinding a transaction at any time, a step that is not subject to review by a U.S. court.¹ The CFIUS process provides parties to a transaction with a voluntary review process, which allows for CFIUS to issue a “no action” decision that protects the parties going forward with a so-called safe harbor provision.

To gain the benefit of the safe harbor, either or both parties to a prospective transaction, merger, or takeover, may voluntarily notify CFIUS and initiate a review, typically before the transaction has closed or been completed. In this situation, CFIUS will analyze the transaction and determine whether it is “covered” and if so, whether it implicates a national security concern.

- In most cases, routine reviews are quickly resolved and the parties will receive a “no action” determination from CFIUS within a 30-day period set forth in the implementing regulations.²

The timeline for such routine types of reviews will also include a 7-14 day pre-filing discussion process with CFIUS, during which the staff of the Treasury Department will ensure that the application is complete, such that the filing can be accepted as soon as the deal has been signed.

For some transactions, FINSA requires CFIUS to undertake a more thorough 45-day investigation, typically after the 30-day review is completed. This includes transactions that involves a transfer of control to a foreign government, which includes companies controlled by foreign governments and sovereign wealth funds.

- CFIUS is also required in certain circumstances to undertake a 45-day investigation of any transaction that would result in the transfer of control of “critical infrastructure” to a foreign person.

If CFIUS determines that the transaction raises significant national security issues, it will undertake a more thorough 45-day investigation. During the investigation, CFIUS will often propose to the parties that they take steps to mitigate any national security concerns.

- FINSA formalized this mitigation process, which had been an informal practice by CFIUS for a number of years, by authorizing CFIUS to enter into agreements with companies to “mitigate” the concerns that had emerged during the review as a condition to approval. Today, CFIUS is authorized to negotiate, modify, monitor and

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The United States Government, including the Congress, are also increasingly concerned with foreign acquisitions of U.S. companies that have been the recipient of significant U.S. Government funding, particularly for research and development of innovative technologies.

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CFIUS does not provide advisory opinions -- an informal practice that was common before 2005, a situation that today is exacerbated by CFIUS cautious approach to potential criticism from Congress should a transaction that is not reviewed subsequently become controversial. This means that the only way in which a transaction will be analyzed by CFIUS is through a voluntary filing.

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Parties to a transaction should always include a condition precedent to closing requiring a CFIUS determination not to take action, or the adoption of a successful remediation program. This is not only critical to protecting the parties from complications due to delays or in the extreme case, having to cancel or unwind the deal. The CFIUS condition also sends a positive signal to CFIUS that the parties are aware of the need for CFIUS to conduct its review and are not taking the process for granted.

¹ In 2012, in the midst of the U.S. Presidential elections, President Obama blocked a transaction by a Chinese company into a wind-farm development. The Chinese company attempted unsuccessfully to challenge the President's decision in court.

² The actual practical details of how CFIUS functions are set out in 31 C.F.R. 800, which contain the Executive's interpretation of the laws passed by Congress that set up the CFIUS process, primarily Exon-Florio and FINSA.

enforce agreements in order to mitigate any national security threats, and mitigation agreements are becoming more common.

- In extreme cases--only one transaction has reached this stage--the President has 15 days to decide whether or not to block the acquisition.

For a better understanding regarding the steps and timing involved in the CFIUS review process, please see Appendices A and B.

CFIUS AND CHINESE COMPANIES

Some recent cases have created the perception that Chinese companies will be subject to a much greater degree of scrutiny by CFIUS. Examples of these cases involving Chinese companies include:

- Acquisition of U.S. companies that are located near U.S. Government facilities.
- Investment that is perceived to be threats to the U.S. cyber infrastructure.
- Investment that is perceived to be risky for transfer of sensitive, export-controlled technology.
- Acquisition of U.S. communications infrastructure.

Despite the above cases, Chinese companies have encountered success in seeking CFIUS' approvals for their proposed investments in the U.S., including the following:

- CFIUS recently cleared CNOOC's buyout of Canada's oil and gas company Nexen Inc. after the latter was reported to have agreed to alter the terms of control structure of its large number of drilling leases in the U.S.³
- Sany was reported to make a subsequent and successful investment in a Colorado wind farm after structuring the investment through ownership by U.S. citizens.⁴
- CFIUS approved the acquisition of most of the assets of Massachusetts-based lithium-ion battery maker, A123 Systems, by China's Wanxiang Group Co.⁵

These recent cases suggested that while CFIUS' review and objection may create significant challenges and even terminate a proposed investment transaction; such risks may be manageable through careful transaction structuring and negotiation of mitigation arrangements with CFIUS.

CFIUS CHECKLIST

To understand whether a transaction may require pre-closing CFIUS review to assess the merits of engaging CFIUS, we recommend walking through an analysis of the seller and buyer:

The Acquiring Entity

- Who owns or controls the foreign acquirer (including all companies in the ownership chain)?
- Is the foreign acquirer directly or indirectly owned or controlled by a foreign government?
- What are the foreign person's plans for the business and its strategic purpose for the acquisition?
- CFIUS asks for the name, address, date of birth, place of birth, nationality, national identification number and passport number for (i) each member of the Board of Directors and senior executives of all companies in the ownership chain; and (ii) any shareholders with 5% or more equity in the foreign acquirer.

3 See "Ralls CFIUS block alters Sany's future investment strategy in US T.com - FT.com", <http://www.ft.com/intl/cms/s/2/1ff1eb98-82b8-11e2-a3e3-00144feabdc0.html#axzz2MOM6qqB9>

4 See "Ralls CFIUS block alters Sany's future investment strategy in US - FT.com", <http://www.ft.com/intl/cms/s/2/1ff1eb98-82b8-11e2-a3e3-00144feabdc0.html#axzz2MOM6qqB9>

5 See "Wanxiang Wins U.S. Approval to Buy Battery Maker A123", <http://www.bloomberg.com/news/print/2013-01-29/wanxiang-wins-cfius-approval-to-buy-bankrupt-battery-maker-a123.html>

PRACTICE POINTER:

A CFIUS notification must include detailed information about the foreign acquirer's owners and shareholders (with 5 % or greater equity) to include name, address, date and place of birth, nationality, national identification number and passport number for (i) each member of the Board of Directors and senior executives of all companies in the ownership chain. While this information is protected by CFIUS from public disclosure, it often is an uncomfortable process for foreign companies to have to seek the disclosure of such detailed information from their shareholders and principals.

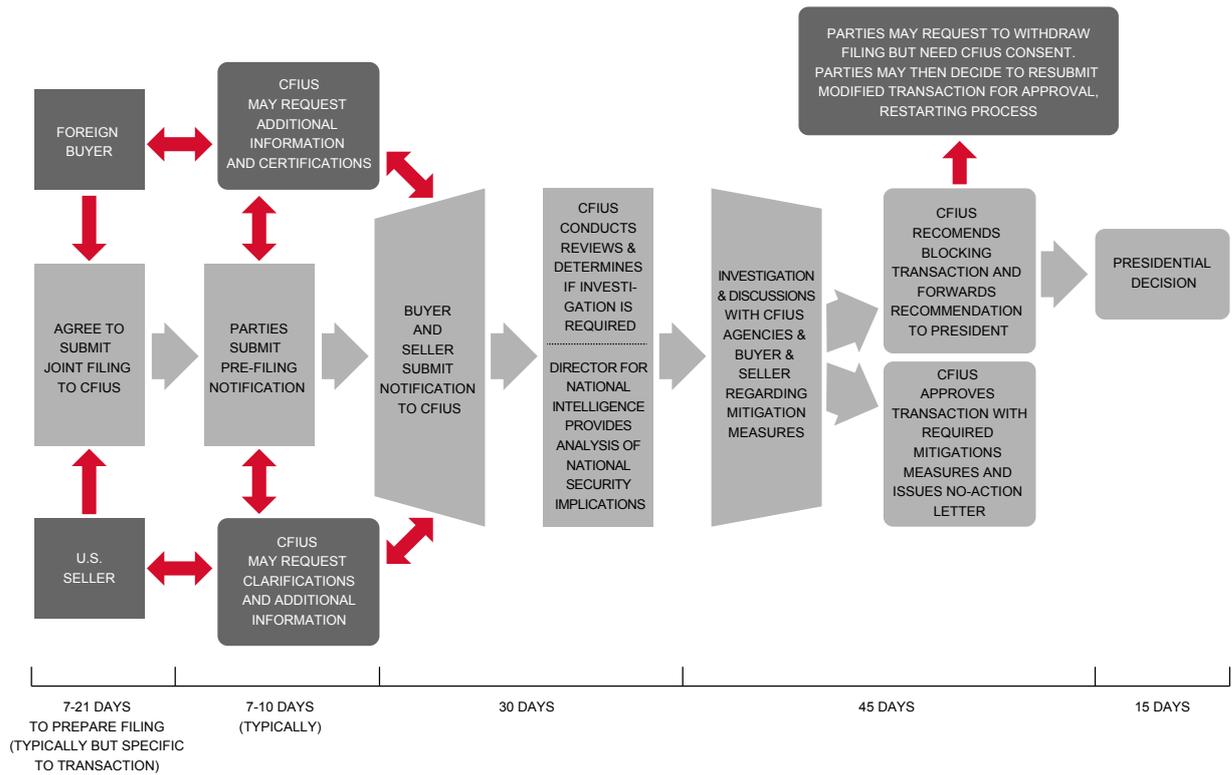
PRACTICE POINTER:

There are many variations of mitigation agreements such as implementation of security plans, periodic compliance audits and certifications, proxy boards made up only of U.S. citizens, or even restructuring of the transaction to hive off a business that CFIUS does not want the foreign party to have any access or control over. Parties to a transaction that is likely to raise national security concerns are well advised to identify the potential diminishment in value to the deal from such measures in advance.

The Target Company

- Does it have a Facility Security Clearance or access to classified data?
- Does it have U.S. government contracts? If so, do any of the contracts involve U.S. government agencies with national security responsibilities?
- Does it produce technology, software or goods listed on a U.S. control list?
- Does it own/have access to/operate critical infrastructure?
- Does it have significant holdings in sensitive resources?
- Could foreign control of the domestic industry in question affect the capability and capacity of the U.S. to meet national security requirements?
- What potential effect will the acquisition have on U.S. technological leadership areas affecting national security?
- Does it have or operate any facilities near U.S. defense facilities?

APPENDIX A: Timeline for Sensitive or Complex Filings



APPENDIX B: Timeline for Uncomplicated Transaction & CFIUS Review

