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# The CFIUS Process: A Primer [\[top\]](#)

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The United States has prided itself on openness to investment by foreign entities, and our competition and other laws generally afford foreign buyers the same treatment as domestic ones. A prominent exception is when foreign investment may have implications for U.S. national security. The Committee on Foreign Investment in the United States (CFIUS) is the federal inter-agency body that is charged with addressing in the first instance the occasional tension between maintaining open U.S. capital markets and national security concerns.

Over the past year, high-profile completed or proposed acquisitions by foreign companies of U.S. businesses, such as IBM's personal computing line, Tyco's undersea fiber-optic network, and the oil company Unocal, have received considerable public and political scrutiny. It might seem, at first blush, that none of these transactions would raise national security issues, unlike a deal involving say missile systems or spy satellites. Yet, each of them was submitted for CFIUS review.

The broadening scope of and debate about potential national security concerns in the post-September 11 era makes it increasingly critical that transactional, antitrust, and other lawyers that counsel foreign investors—as well as U.S. firms seeking foreign investment—understand the basics of CFIUS. (They should at least be able to flag possible issues and any regulatory risk the transaction might create for consulta-

tion with a CFIUS expert.) Here, we first briefly describe the background of CFIUS, the scope of CFIUS's authority, and the basics of the CFIUS review process. We then discuss some important strategic issues for transactions that may fall under CFIUS's purview. Finally, we briefly outline some possible future changes to the CFIUS process.

## Background

In 1988, in response to concerns about possible effects of foreign direct investment on national security, Congress enacted the Exon-Florio amendment to the Defense Production Act.<sup>1</sup> Exon-Florio authorizes the President to investigate the impact on U.S. national security of "mergers, acquisitions, and takeovers" by foreign persons that result in foreign control over a U.S. company or certain U.S. assets. If the President finds: (1) "credible evidence" that a transaction would impair national security; and (2) that no other provision of law grants him authority to take steps to ameliorate this impact, he may take action to block the transaction. The President's findings are not subject to judicial review.

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<sup>1</sup> 50 U.S.C. app. § 2170.

Exon-Florio applies not just to proposed mergers and acquisitions; the President is also empowered to seek judicially-ordered divestiture of completed acquisitions. Further, unless a party to the transaction avails itself of the voluntary CFIUS notification and review process, discussed below, there is no limitations period on the President's authority to investigate a past transaction—though the review must relate to facts or circumstances existing at the time of the transaction. (Under the implementing regulations for Exon-Florio, however, only the CFIUS chair may initiate review of a completed transaction after three years from the date the acquisition is completed.)

CFIUS, an inter-agency body with 12 members, established by executive order, implements Exon-Florio. The Secretary of the Treasury, who chairs the Committee, and the Departments of Defense, Homeland Security, Commerce, and Justice typically take the most active roles in the CFIUS process. Other members of the President's cabinet and economic and national security bodies within the Executive Office of the President also serve on the Committee. Depending on the nature of the transaction at issue, different Committee members tend to have varying degrees of involvement. For instance, the Justice Department has been very involved in certain telecommunications acquisitions that were thought to have possible implications for U.S. law enforcement's ability to conduct wiretapping.

The staff of the Office of International Investment of the Department of the Treasury administers the CFIUS process. The Committee's review process is confidential, and the process is intended to focus on the true national security implications for particular deals rather than political considerations.

## Scope and Focus of CFIUS Review

Because transactions not voluntarily notified to CFIUS can be investigated or even unwound post-closing, parties to foreign acquisitions of a U.S. company or certain U.S. assets<sup>2</sup> are well-advised to determine whether the deal might be appropriate for notification. In that regard, parties contemplating a transaction should ask themselves: (1) does the deal involve a "foreign" person acquiring a "United States" person? and (2) might the transaction implicate U.S. national security interests?

### "Foreign" and "United States" Persons

Although determining the answer to the first question is often straightforward, counsel must be mindful of the specific, overlapping definitions of "foreign" and "United States" persons in the context of the Exon-Florio regulations. For example, any entity is a U.S. person to the extent of its business activities in the United States. This means that a U.S. branch office or subsidiary of an ultimately foreign-owned company is deemed a U.S. person, and application of the statute could be triggered if a different foreign parent acquires the branch office or subsidiary. Because the branch or subsidiary is under foreign control, moreover, it is deemed a foreign person for purposes of the statute if it acquires a U.S. company.

### "National Security"

The second inquiry, whether the transaction raises potential U.S. national security implications, is more open-ended. As the preamble to the CFIUS regulations explains, the term "U.S.

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<sup>2</sup> An acquisition of U.S. assets can trigger application of Exon-Florio if they constitute a "business." 31 C.F.R. §§ 800.301(b)(4), 302(e).

national security" will be "interpreted broadly and without regard for particular industries[,]" its scope lying wholly "within the President's discretion."<sup>3</sup> The statute itself includes some factors for determining whether a transaction has the potential to affect national security including: whether domestic production is needed for national defense goods; the capability of domestic industry to meet those requirements; the effect foreign control over production might have on meeting national defense needs; whether foreign control will lead to an increased risk of proliferation of weapons of mass destruction and missile technology; and the impact of the transaction on U.S. technological leadership in defense areas.

In practice, the Committee often has particular interest in transactions when the target U.S. company has export-controlled technologies, classified contracts with the U.S. government, or technologies critical to national defense; or when CFIUS member agencies have specific "derogatory intelligence" about the foreign purchaser.<sup>4</sup> These factors, however, are only general guidelines and are by no means exhaustive, as the following examples illustrate.

### Examples of Past Transactions

A few recent examples illustrate the sort of transactions that have reportedly received substantial CFIUS scrutiny.

Press reports suggest that in its 2003 review of a proposed acquisition of Global Crossing's fiber optic network, the Committee focused on the security of U.S. data transmissions and U.S. law enforcement's ability to access the

networks for wiretaps.<sup>5</sup> CFIUS, however, also raised concerns that one of the acquiring partners, Hutchinson Whampoa Ltd. of Hong Kong, had ties to the Chinese military. During the initial CFIUS review, Hutchinson offered to play a purely passive role in the acquired business in order to obtain approval. When CFIUS announced that it was initiating a further 45-day investigation, however, Hutchinson withdrew from the deal. Ultimately, CFIUS cleared an acquisition by Singapore Technologies Telemedia Ltd., a Singapore firm that was originally partnered with Hutchinson.

In April 2005, CFIUS cleared a \$130 million acquisition of Tyco International's undersea fiber-optic cable network by an Indian firm, Videsh Sanchar Nigam Ltd. (VSNL), during the 30-day initial review. VSNL reportedly entered into data security agreements with U.S. law enforcement and defense agencies as a condition of approval.<sup>6</sup>

In 2005, CFIUS has factored in at least two other high profile transactions, both involving Chinese firms: Lenovo Group's purchase of IBM's personal computing business and CNOOC's bid for U.S. oil firm Unocal. CFIUS cleared Lenovo's acquisition during the initial 30-day review period, during which scrutiny reportedly focused on whether the company's access to IBM's contracts with the U.S. government could result in the Chinese government gaining access to sensitive intelligence.<sup>7</sup> For Unocal, public concerns centered

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<sup>3</sup> 31 C.F.R. § 800 app. A (2004).

<sup>4</sup> GAO Sept. 2005 at 12.

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<sup>5</sup> Ron Orol, CFIUS Set to Rule on Global Xing, *The Deal*, Sept. 3, 2003.

<sup>6</sup> Ron Orol, Tyco Sale of Cable Assets is Approved, *The Deal*, April 15, 2005.

<sup>7</sup> Jonathan Peterson, Panel Has a Big Say in Foreign Purchases: Security clearance for a Chinese bid for

on the possibility of the Chinese government (through CNOOC) using Unocal to exercise undue influence over U.S. energy supplies. Some reports suggested that Unocal's underwater mapping technology also might have raised issues.<sup>8</sup> Unocal's board ultimately rejected CNOOC's offer in favor of another, lower bidder, possibly based on concerns about delays and a possible negative outcome from a CFIUS review.

## The CFIUS Review Process

### Overview

The CFIUS review process has some structural similarities to the Hart-Scott-Rodino process, though filings are voluntary, no filing fee is required, and no mandatory waiting period is imposed. The process consists of four steps: (1) a voluntary filing with CFIUS by one or more parties to the transaction; (2) a 30-day Committee review of the transaction; (3) a potential additional 45-day Committee investigation; and (4) the President's decision to permit or deny the acquisition (or seek divestiture after an ex post facto review).

CFIUS approves the overwhelming majority of notified transactions during the initial 30-day period. Sometimes this occurs after the parties have taken steps to mitigate concerns about the transaction—typically after having discussed the issues with CFIUS or member agencies before filing. Parties occasionally withdraw and re-file their application to give the Committee more time to complete its review.

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Unocal would hinge on an obscure U.S. committee, L.A. Times, July 5, 2005 at C1.

<sup>8</sup> Steve Lohr, Unocal Bid Opens Up New Issues of Security, The New York Times, July 13, 2005.

The initial filing and the Committee's review process are confidential. If the process reaches the presidential decision stage, the Exon-Florio statute requires that the President make a mandatory report to Congress. Although the statute directs that the report should not disclose to the public information and documentation provided during the review, portions of such reports have become public in the past.

### The Voluntary Filing

The CFIUS process begins with a voluntary filing seeking review of a proposed or completed transaction by one or more of the parties to an acquisition of a U.S. company, or certain U.S. assets, by a foreign company. A CFIUS filing is not mandatory for any transaction. Although the Exon-Florio regulations empower members of CFIUS themselves to file notice with the Chair of the Committee and trigger a CFIUS review, a recent study by the Government Accountability Office found that they have never used that authority.<sup>9</sup> In practice, when a CFIUS member agency wishes to subject an acquisition to review, agency or CFIUS staff contact the parties and request submission of a voluntary filing.<sup>10</sup>

For transactions that raise issues, parties generally engage in pre-filing consultations and negotiations with the Committee or member agencies before making their official notification. Although these discussions are not part of the formal CFIUS process, they often influence the outcome. Parties sometimes modify their transaction before filing to expedite clearance. In some cases, parties have aban-

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<sup>9</sup> U.S. Gov't Accountability Office, GAO-05-686, Enhancements to the Implementation of Exon-Florio Could Strengthen the Law's Effectiveness 9 (Sept. 2005).

<sup>10</sup> Id.

done transactions after it became clear that the Committee would not clear them (or would not on terms acceptable to the parties).

The implementing regulations spell out in detail the required contents for a filing.<sup>11</sup> In general, the filing must contain a detailed description of the transaction, including timelines and assets or businesses to be acquired. CFIUS also requires detailed background concerning the parties. For the target U.S. firm, the filing must identify, among other things, sensitive technologies or information that the firm possesses and U.S. government contracts to which it is party. For the foreign acquirer, the filing must, among other things, describe future plans for the acquired company or assets and provide detailed information about the parties' ownership structure—especially when the foreign acquirer is owned in whole or part by a foreign government. In addition, the parties must disclose whether they are required to submit the transaction for review under other U.S. national security laws, such as export control regimes.

### **The Initial 30-Day Review**

The 30-day initial review period begins to run once the CFIUS staff gives notice that they are satisfied that the filing contains all of the required information. Although only one party to the transaction need file notice to trigger a review, because information about all parties is required, the Committee may delay the beginning of the review period until the required information about other parties is received. Indeed, CFIUS staff interprets the regulations to require a joint filing when the transaction is not hostile.

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<sup>11</sup> 31 C.F.R. §§ 800.401-404 (2004).

During this initial period, the Committee disseminates to its members information about the transaction for review, analysis, and comment. The parties may be invited, or may themselves request, to meet with CFIUS staff during the 30-day initial review (or during any extended 45-day review period) to discuss the transaction. The Committee staff or a member agency may contact the parties for further information or to discuss steps that would mitigate any national security concerns that the transaction raises.

In some cases, CFIUS may condition clearance at the end of the 30-day period on such mitigation steps. In 2000, for example, CFIUS required Nippon Telephone and Telegraph Company to agree to bar the Japanese government from any involvement with the firm as a condition for clearing its acquisition of Verio, Inc., an Internet service provider.<sup>12</sup> In 2001, CFIUS cleared a Dutch firm's acquisition of a U.S. company after the Dutch firm agreed to divest itself of the U.S. company's optics and semiconductor businesses, which produced technology used to manufacture components for U.S. spy satellites.<sup>13</sup>

### **The Close of the 30-Day Initial Review Period: Clearance, Investigation, or Withdrawal**

At the end of the 30-day initial review period, CFIUS is required either to clear the transaction based on its initial review, or if it cannot do so, begin an additional 45-day investigation which culminates in a formal Presidential de-

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<sup>12</sup> James K. Jackson, Cong. Research Serv., The Exon-Florio National Security test for Foreign Investment 5 (2005) [Hereinafter CRS Report].

<sup>13</sup> Jonathan Peterson, L.A. Times, supra note 7.

cision to clear, suspend, or prohibit the deal.<sup>14</sup> This extension of the Exon-Florio review is somewhat analogous to a second request under the Hart-Scott-Rodino Act. An extended investigation can require submission of a substantial amount of additional information and large numbers of documents.

In practice, however, CFIUS may informally request that the parties withdraw notice before the end of the 30-day initial review period if the Committee needs more time or information to fully review the transaction, or the parties have not agreed to mitigating conditions requested by agencies. If the parties re-file notice for the same transaction, the 30-day review begins anew from the date of the new filing. Similarly, if the parties make a material change to their filing at anytime during the process, the clock will begin again from the day the parties file the change with CFIUS.

### **The 45-Day Post-Review Investigation and Presidential Decision**

If CFIUS proceeds with a full investigation of the acquisition, it must conclude its additional review within 45 days. At the conclusion of the investigation, it will submit a recommendation to the President. Normally, the Committee makes a unanimous recommendation, but if the members are divided they will forward their differing views to the President. The President has 15 days from the date of referral to clear, prohibit, or suspend the transaction.

According to a report by the Congressional Research Service, out of more than 1,500 fil-

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<sup>14</sup> The statute requires the Committee to initiate a 45-day investigation when an entity controlled by or acting on behalf of a foreign government engages in an acquisition that could affect national security. 50 U.S.C. app. § 2170 (b).

ings with CFIUS made since passage of Exon-Florio, CFIUS has launched 45-day reviews in only 25 cases. (As noted above, however, it is not uncommon for parties to avoid an extended review by modifying their transaction.) Of the 25 cases, in 13 the parties withdrew the notice before the conclusion of the investigation,<sup>15</sup> in some instances terminating the transaction and in others re-filing after modifying the deal or providing more information to the Committee.<sup>16</sup> In the 12 other cases,<sup>17</sup> CFIUS submitted the matter to the President, which apparently led to modification of the transaction in several instances. In only one case has the President denied clearance: a 1990 acquisition of a U.S. aerospace manufacturer by a Chinese firm. The President grounded his decision in concerns that the acquisition might allow the Chinese company to circumvent certain technology export control regimes.<sup>18</sup> As noted above, however, in some cases parties have abandoned transactions after it became clear from informal discussions that they would be unable to obtain clearance.

### **Approval of a Transaction**

If the parties obtain CFIUS approval—whether during the 30-day initial review or by Presidential decision—the acquisition will enjoy a "safe harbor" from subsequent Exon-Florio challenges. The only exception is if a party submitted false or misleading material information or omitted material information in its communications with CFIUS.

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<sup>15</sup> CRS Report at 4.

<sup>16</sup> U.S. Gov't Accountability Office, GAO-02-736, Mitigating National Security Concerns Under Exon-Florio Could be Improved 6 (Sept. 2002).

<sup>17</sup> CRS Report at 4.

<sup>18</sup> Id.

## Strategic Considerations

For transactions involving the foreign acquisition of a U.S. company or assets that may raise questions relating to national security, Exon-Florio and the CFIUS process raise two key questions: (1) Whether to file a voluntary notice with CFIUS? (2) If yes, when to file?

### Deciding Whether to File

In deciding whether to file a voluntary notice, counsel should first evaluate whether any government authorities might perceive the transaction as having implications for national security. In doing so:

- The parties should construe the definition of national security broadly, taking into account, for example, potential implications for law enforcement and counter-terror capabilities. It is important to pay particular attention to topical areas of public concern, such as "energy security."
- Parties should scrutinize CFIUS considerations particularly closely when the U.S. target maintains sensitive, classified, or export-controlled information and technologies or has contracts with government agencies like the Department of Defense, the Department of Homeland Security, or the intelligence community.
- The nationality and the structure of the ownership and control of the foreign acquiring company—especially any connections to foreign governments—are critical factors in the analysis.

Counsel should next weigh the benefits of a voluntary filing with CFIUS versus costs and burdens involved. Among the benefits of securing CFIUS clearance:

- "Safe harbor" from future Exon-Florio review and possibility of post-transaction unwinding; thereby eliminating a continuing cloud over the transaction following closing.
- The opportunity to address CFIUS issues affirmatively on the client's own terms rather than being forced to start from a defensive posture after the Committee has initiated a review.
- Generating goodwill for the acquiring company within CFIUS, its member agencies, and Congress by signaling sensitivity to U.S. national security concerns.
- Potentially facilitating approvals that may be required from specific U.S. government agencies.

The costs and burdens include:

- The costs of generating the required information and making the necessary submissions as well as the delays inherent in the review process. (In some cases a party may seek to establish CFIUS clearance as a condition precedent to closing the transaction).<sup>19</sup>
- Concessions CFIUS might require in return for approval of a transaction. In past transactions, such concessions have included divesting subsidiaries with sensitive technology, "walling off" the foreign parent from control of the U.S. entity and access to certain information, or entering

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<sup>19</sup> Absent such a condition, the parties may opt to close a transaction before obtaining CFIUS clearance, but, in doing so, they assume the risk that the President could order a divestiture or the imposition of post-closing conditions.

agreements concerning network security or government access to critical telecommunications infrastructure. (Of course, these concessions might be required in any event if CFIUS initiates an investigation itself, so self-reporting will very often be in the parties' best interest even when approval is likely to be conditioned on concessions.)

- The risk that notification itself might raise issues that would not otherwise have triggered scrutiny, although that risk will often be relatively small given the ready availability of information about most transactions.

Another factor to consider is how spurned competing bidders, business rivals, or other stakeholders might attempt to seek advantage through the CFIUS process. As is the case with deals that are subject to antitrust risk, a suitor that does not raise regulatory risks sometimes tries to impress on the target the advantages of selling to it rather than a riskier buyer; and successful bidders sometimes must pay an added premium or agree to conditions such as break-up fees to compensate the target for the risk. In the case of unsolicited or hostile bids, a target company might try to use the CFIUS process to call into question or delay the closing of the transaction.

Finally, before making a filing, counsel should strongly consider informal consultation with the CFIUS staff about the transaction, whether a filing is required, and how best to proceed.

### **Deciding When to File**

When to file is often almost as important a strategic consideration as whether to file. A key factor to consider is the amount of scrutiny and controversy that the transaction is likely to generate among the CFIUS members. Although the review and decision timelines for the formal CFIUS process are relatively short, the Committee can ask the parties to withdraw

and re-file to give itself more time to examine a transaction, and the parties will usually be hard-pressed to refuse if they wish to avoid a burdensome, 45-day extended review. Therefore, especially if the deal is contingent on CFIUS approval, filing earlier in the deal-making process makes sense if extended review is anticipated.

Similarly, if concessions are likely to be required, it often makes good sense to begin discussions with the Committee and interested members before making a filing. By doing so, it is often possible to resolve (or at least go far towards resolving) the question of concessions before the parties make their CFIUS notification. Parties often obtain the best results, both in terms of timing and ultimate outcome, by beginning a dialogue very early in the process.

Another factor is the interaction between CFIUS review and other types of regulatory scrutiny. Counsel should consider whether successfully completing the CFIUS process may facilitate other required national security reviews or evaluations undertaken by other agencies, such as export control reviews. Obtaining another approval before notifying the transaction to CFIUS may help facilitate the CFIUS review or facilitate a common set of conditions; in other cases, filing with CFIUS before another review may make sense for similar reasons. Of course, the CFIUS process can run concurrently with other forms of governmental review. In many cases, it will make sense simply to notify a transaction with CFIUS at the same time as the parties make other regulatory filings—such as a Hart-Scott-Rodino notification.

### **The Future: Possible Changes to CFIUS**

The post-September 11 environment as well as some prominent recently completed and proposed transactions—such as Hutchinson-Global



Crossing, Lenovo-IBM, and CNOOC-Unocal—have led to increased scrutiny and some criticism of the CFIUS process. Some have argued that the process lacks transparency, that timelines for review are too short to be effective, and that the Committee takes too narrow a view of U.S. national security interests in evaluating deals. Legislation has been proposed to:

- Expressly expand CFIUS review of national security issues to include "energy security" and "economic security";
- Make the Secretary of Defense, rather than the Secretary of the Treasury, the CFIUS chair;
- Give Congress power to overturn a CFIUS or Presidential approval of a deal through a resolution of disapproval;
- Extend the time periods for the various stages of the CFIUS process.

As of this writing, it is unclear what amendments, if any, Congress may make to Exon-Florio. But companies considering foreign investments in the U.S. and companies that may sell to a foreign buyer should be mindful of the often-shifting political context in which the CFIUS process takes place. Congressional changes to Exon-Florio could have important implications for the CFIUS review process and the regulatory risk to transactions.