United States

Robert S LaRussa and Lisa S Raisner
Shearman & Sterling LLP

Law and policy

1 What, in general terms, are your government's policies and practices regarding oversight and review of foreign investment?

The United States has had mechanisms in place to track and review foreign direct investment since 1975, when President Ford established the inter-agency Committee on Foreign Investment in the United States (CFIUS). While those mechanisms were formalised and strengthened by statute in the 1980s, the current US approach regarding government oversight of foreign investment in the United States clearly stems from the events of 11 September 2001.

With the attacks on the World Trade Center, Americans were confronted with the reality that they were vulnerable to terrorist assaults on US soil, and the US government was faced with the policy choice of how to balance the economic need for open foreign investment with the national security need to protect US assets, particularly critical infrastructure. Politics and policy met head on a few years later, with the 2006 acquisition by Dubai Ports World, a company owned by the government of Dubai, of a firm that ran terminal operations at six US ports.

The prospect of having a government-owned company from the Middle East, even one from as strong a US ally as the United Arab Emirates, created a political firestorm in Washington, as did the approval of the acquisition by CFIUS. The US Congress responded with two years of intense debate that resulted in a 2007 law overhauling the process by which the United States reviews the national security implications of US foreign investments. That law, the Foreign Investment and National Security Act of 2007 (FINSA), required CFIUS to apply heightened scrutiny to certain types of investments, particularly those that could result in foreign control over US critical infrastructure, broadly defined, or those that could result in control of a US business by a foreign government.

While US law does not, in many respects, indicate exactly which investors should be scrutinised, guidance to the regulations implementing FINSA suggests that the questions of 'who' and 'what' do matter greatly. According to the regulatory guidance issued by CFIUS, the determination of 'National Security Risk is a function of the interaction between threat [whether the foreign person has the capability or intent to cause harm] and vulnerability [whether the nature of the US business or some weakness in the system creates a susceptibility to harm], and the consequences of that interaction for US national security.' More specifically, in making that calculation, the government reviews transactions case by case in the context of all facts and circumstances, but specifically looks to factors that relate, in part, back to post-9/11 concerns, such as US defence production requirements, the effect on US critical technologies and critical infrastructure, international technological leadership in areas affecting national security, US energy requirements, the potential control of a US business by a foreign government and the foreign country's potential for diversion of military technology and cooperation with US anti-terrorism efforts, among others.

2 What are the main laws that directly or indirectly regulate acquisitions and investments by foreign nationals on the basis of the national interest?

The primary vehicle for reviewing foreign acquisitions of US businesses on the basis of national security is section 721 of the Defense Production Act of 1950, as amended by FINSA. Under this law, the US President may review the national security implications of acquisitions of or investments in US businesses by foreign persons and may block or unwind such transactions when they threaten US national security. These national security reviews have been delegated to CFIUS, an inter-agency committee chaired by the US Treasury Department. CFIUS has the authority to review any such transaction that could result in foreign control of any person engaged in interstate commerce in the United States.

3 Outline the scope of application of these laws, including what kinds of investments or transactions are caught. Are minority interests caught? Are there specific sectors over which the authorities have a power to oversee and prevent foreign investment or sectors that are the subject of special scrutiny?

CFIUS reviews cover only acquisitions or investments that could result in foreign control over a US business, and 'control' is the overriding factor in determining CFIUS jurisdiction. The law, however, provides CFIUS with broad discretion to determine whether an investment involves a change of control. CFIUS can find that a foreign investor has acquired control over a US business through either a majority or a minority interest. CFIUS will consider the size of the investor's interest but will also evaluate a number of other factors, including whether the interest is voting or non-voting, any board representation, formal or informal arrangements to act in concert with other investors, and any means by which an investor can make or influence key corporate decisions. Such key corporate decisions include, but are not limited to, the following:

- the sale of assets;
- the reorganisation of the US business;
- the closing or moving of business facilities;
- major expenditures or investments; the entry into or termination of significant contracts;
- the hiring or firing of senior management; and
- the amendment of the organisational documents of the US business with respect to these types of matters.

Additionally, CFIUS will consider an investment through which a minority investor acquires veto rights over key corporate decisions to involve a change of control by virtue of the investor's negative control over the US business.

The CFIUS regulations carve out a limited 'safe harbour' for certain minority investments. They exclude from CFIUS jurisdiction transactions that result in 'a foreign person holding 10 per cent or less of the outstanding voting interest in a US business' if 'the transaction is solely for the purpose of passive investment'.

Investments are made solely for the purpose of passive investment where the foreign person 'does not intend to exercise control, does not

possess or develop any purpose other than passive investment, and does not take any action inconsistent with passive investment'. The CFIUS regulations also identify certain typical minority shareholder protections that are not considered, by themselves, to confer control over a US business. These include, among others, the power to prevent the sale of all or substantially all of the assets of an entity or a voluntary filing for bankruptcy or liquidation; and the power to prevent an entity from entering into contracts with majority investors or their affiliates.

CFIUS reviews cover sales of both shares and assets, to the extent that such shares or assets constitute a US business. Joint ventures are covered to the extent that a US business is contributed as part of the joint venture and a foreign person gains control over the US business as part of that transaction. CFIUS will assert jurisdiction over the acquisition of one foreign company over another, but only to the extent that the target has assets considered to be a US business.

While the CFIUS regulations do not point to specific sectors for which the filing of a CFIUS notice is required, they do provide special considerations for acquisitions or investments in sectors that could be considered 'critical infrastructure'. 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 of the entity over which control is acquired pursuant to that covered transaction would have a debilitating impact on national security'. Sectors such as energy, telecommunications, transportation and information technology certainly fall within this definition, as do many others. The regulations take 'critical infrastructure' into account in a number of ways. For example, a second-stage 45-day CFIUS investigation is mandatory for transactions resulting in control of critical infrastructure by a foreign person if CFIUS determines the transaction could impair national security. In conducting its national security analysis, US law requires CFIUS to examine, among other things, 'the potential national security-related effects of the transaction on US critical infrastructure, including [physical critical infrastructure such as] major energy assets'. In addition, transactions directly or indirectly related to the defence industry have always been a key focus of CFIUS scrutiny, especially if the US business holds US government contracts related to defence or homeland security, or makes products subject to the requirements of the International Traffic in Arms Regulations.

4 How is a foreign investor or foreign investment defined in the applicable law?

The term 'foreign person' is defined as any foreign national, foreign government, or foreign entity, or any entity over which control is exercised or exercisable by a foreign national, foreign government or foreign entity. The term foreign entity is defined broadly to include any branch, partnership, group or subgroup, association, estate, trust, corporation or division of a corporation, or organisation organised under the laws of a foreign state if either its principal place of business is outside the United States or its equity securities are primarily traded on one or more foreign exchanges, unless it is shown that a majority of the equity interest in such an entity is ultimately owned by US nationals.

5 Are there special rules for investments made by foreign state-owned enterprises (SOEs) and sovereign wealth funds (SWFs)? How is an SOE or SWF defined?

Transactions that could result in the control of a US business by foreign governments or entities controlled by foreign governments were a key focus of the 2007 FINSA amendments. CFIUS national security reviews begin with an initial 30-day review, followed by an additional 45-day investigation in certain cases. Under FINSA, a full 45-day investigation is required when the 30-day review reveals the potential for a transfer of control over a US business to a foreign government or an entity controlled by a foreign government. There is a limited exception when the Secretary of the Treasury and the head of the lead agency for the initial review determine that the proposed transaction would not impair national security, but such a determination must be made at the deputy secretary level, and cannot be delegated to lower-level officials. Given the political sensitivity surrounding certain types of foreign investments, and congressional interest in the CFIUS process, such waivers are not likely in any review that could in any way be considered controversial, including investments made by foreign government-controlled entities from nations that are not considered natural US allies. Interestingly, CFIUS in its regulations rejected the suggestion by some commentators that it adjust this rule for investments made by government-controlled entities that operate on a purely commercial and market-driven basis, noting that FINSA makes no such distinction.

The CFIUS regulations define the term foreign government controlled transaction as 'any covered transaction that could result in control of a US business by a foreign government or a person controlled by or acting on behalf of a foreign government'. They further define foreign government as 'any government or body exercising governmental functions, other than the United States government or a subnational government of the United States'. As such, the term foreign government includes, but is not limited to, national and subnational governments, including their respective departments, agencies and instrumentalities. The terms SWF and SOE are not specifically defined in the CFIUS regulations but fall within the definitions discussed above.

Investments by SWFs and SOEs have received a great deal of attention in the United States in recent years, and members of the US Congress, as well as commentators and members of the media, have at times called for more stringent controls on their investments in the United States. Among the concerns raised is the possibility that an SWF or SOE could use its interests in US businesses as a basis for political rather than market-based decisions. CFIUS is sensitive to such considerations and commentary.

6 Which officials or bodies are the competent authorities to review mergers or acquisitions on national interest grounds?

The national security reviews authorised by US law have been delegated to CFIUS. The US Treasury Department, which chairs CFIUS, maintains a permanent CFIUS staff in its Office of Investment Security and works with a number of other agencies that are, by statute, members of CFIUS. These include the Departments of Homeland Security, Commerce, Defense, State, Energy and Labor, as well as the Attorney General, the Director of National Intelligence, and the heads of any other executive department, agency, or office the President determines appropriate. In 2008, President Bush added the US Trade Representative and the Director of the Office of Science and Technology Policy as full CFIUS members. The Secretary of the Treasury appoints a lead agency for each CFIUS review, based on the issues at play in that particular review and the expertise of the agency.

7 Notwithstanding the above-mentioned laws and policies, how much discretion do the authorities have to approve or reject transactions on national interest grounds?

The President has wide discretion in determining whether a transaction threatens US national security. Specifically, the President may block a transaction if he or she finds that there is 'credible evidence' that leads him or her to believe that the 'foreign interest' proposing to acquire a US company 'might' take action that 'threatens to impair the national security'. Neither the statute nor the CFIUS regulations explicitly define 'national security', but the term is interpreted broadly and includes those issues relating to 'homeland security', including its application to critical infrastructure.

Procedure

8 What jurisdictional thresholds trigger a review or application of the law? Is filing mandatory?

Under the CFIUS regulations, 'any branch, partnership, group or subgroup, association, estate, trust, corporation or division of a corporation [...] or assets' operated as a business that is engaged in interstate commerce in the United States is considered a US business. FINSA gives companies involved in cross-border acquisitions or investments in US businesses the opportunity to voluntarily obtain a clearance of the transaction by filing a notice thereof with CFIUS at no cost to the parties.

Although this clearance process is voluntary, CFIUS can initiate its own investigation of a transaction if the parties do not choose to file a voluntary notice. Without CFIUS clearance, the President retains the power to block or unwind a transaction indefinitely, such that a transaction is open to potential unravelling at any time. If successful, a CFIUS review results in a 'no-action' letter from CFIUS insulating the transaction from subsequent presidential action. If, in the course of the review, CFIUS determines that the transaction as presented is not subject to its jurisdiction, it will notify the parties, concluding the CFIUS process.

9 What is the procedure for obtaining national interest clearance of transactions and other investments? Are there any filing fees?

As part of the CFIUS review process, both foreign investors and the US target company must submit a range of business information to CFIUS, including information about the foreign investors and their parents, the US targets of the investment or acquisition, and detailed information about the transaction. There is no standard form for the filing, nor is there a filing fee, but all information required by the statute and regulations governing CFIUS reviews must be included with the filing, so in that respect the required information is well defined, if not in a standardised form. The specific information required by the CFIUS regulations includes, but is not limited to, detailed information on the transaction, the US business and the foreign person. Following the initial filing and throughout the process CFIUS can ask questions and require additional information even if it is not specified by the regulations.

While the process is voluntary, CFIUS can initiate its own investigation and has notified parties after it has identified a transaction of interest.

10 Which party is responsible for securing approval?

Notices filed with CFIUS are filed jointly by the foreign investor and the US target. Parties to the transaction are required to submit to CFIUS all information called for by the regulations, and CFIUS may reject notices at any time that do not fully comply with these regulatory requirements, or for which parties do not respond in a timely fashion to follow-up questions from CFIUS. Parties also must provide a final certification to CFIUS attesting to the accuracy of the information that has been submitted. In rare cases, such as a hostile takeover situation, the notice can be filed by one party but it is extremely difficult to meet all the information requirements.

11 How long does the review process take? What factors determine the timelines for clearance? Are there any exemptions, or any expedited or 'fast-track' options?

The initial CFIUS review takes 30 days, at the end of which CFIUS will either issue a 'no-action' letter clearing the transaction or will initiate a second-stage investigation, which lasts an additional 45 days. CFIUS will undertake a second-stage, 45-day investigation if any CFIUS member agency believes at the end of the initial 30-day review that the transaction under review threatens to impair US national security and that the threat has not been mitigated. In addition, the second-stage investigation is mandatory for transactions involving foreign-government controlled transactions and transactions resulting in control of critical infrastructure by a foreign person if CFIUS determines that the transaction could impair national security. As noted, CFIUS may waive these requirements of a 45-day investigation with the consent of certain high-level officials in the agencies chairing a CFIUS review. At the end of the 45-day second-stage investigation, CFIUS has another opportunity to conclude its review of the transaction and issue the parties a 'no-action' letter. If CFIUS cannot clear a transaction during this second stage due to national security concerns raised by one of its member agencies, CFIUS will send a recommendation regarding the transaction to the President, who has 15 days to decide whether to block or unwind the transaction or to allow it to proceed.

12 Must the review be completed before the parties can close the transaction? What are the penalties or other consequences if the parties implement the transaction before clearance is obtained?

While there is no obligation that parties refrain from closing a transaction prior to obtaining CFIUS approval, it is prudent to do so if there is any chance that CFIUS may not approve the transaction. Without CFIUS clearance, the President retains the power to block or unwind a transaction indefinitely, such that a transaction is open to potential unravelling at any time, even months or years after closing. CFIUS has, on a number of occasions in recent years, required parties to make a CFIUS filing after the transaction had already closed.

13 Can formal or informal guidance from the authorities be obtained prior to a filing being made? Do the authorities expect pre-filing dialogue or meetings?

CFIUS will generally agree to meet with parties to discuss potential transactions, even in cases in which the parties do not plan to make a formal CFIUS filing or are unsure about how to proceed. While CFIUS makes it clear in such meetings that they do not give formal advisory opinions, CFIUS officials are usually willing to meet informally to hear about pending transactions. In addition, the CFIUS regulations formalised the process of providing CFIUS with a pre-notice filing, something that had been followed in practice prior to that. While CFIUS will not comment on the likelihood of approval in this pre-filing process, it will indicate whether the draft meets the requirements to initiate a review.

14 When are government relations, public affairs, lobbying or other specialists made use of to support the review of a transaction by the authorities? Are there any other lawful informal procedures to facilitate or expedite clearance?

Typically, the clearance process is handled by the parties' legal advisors, who specialise in national security reviews. Public affairs specialists and lobbyists, as well as industry experts and other specialists, are also sometimes used as part of a CFIUS clearance effort in cases in which a CFIUS filing could be controversial or in which there is considerable interest on the part of the US Congress. In a number of recent cases, there has been a considerable amount of negative press about some foreign acquisitions of US businesses, and in such cases the status of CFIUS reviews often becomes a matter of speculation. In such cases, there are, at times, antagonists trying to influence the media, for political or financial reasons, and it is therefore critical for the US business and the foreign investor to balance the equation either through internal public affairs officers or an outside public-relations firm. A press strategy should be developed before the story gets out of hand, as it is often difficult to counter factual inaccuracies once they are in the media and on the internet. In such instances, it is also important to make contact with the members of Congress who sit on the committees of jurisdiction on CFIUS matters, as well as their staff. It is also important to recruit congressional supporters of such foreign investments, for example, those who represent areas where there might be job creation as a result of an investment – and to identify potential opponents of the investment. In some cases involving the acquisition of a US business with cutting edge or complex technology, it is helpful to involve industry analysts who can help explain the nature of the technology to CFIUS.

15 What post-closing or retroactive powers do the authorities have to review, challenge or unwind a transaction that was not otherwise subject to review?

Without CFIUS clearance, the President retains the power to block or unwind a transaction indefinitely. Only a 'no-action' letter from CFIUS, issued as part of a formal CFIUS filing, guarantees that a foreign acquisition of a US business is insulated from future action by CFIUS or the President. It is also possible that a post-closing change in ownership or other material terms that could result in a change of control from one foreign person to another could create the need for a new CFIUS filing, but that would, in effect, represent a new transaction.

Substantive assessment

16 What is the substantive test for clearance and on whom is the onus for showing the transaction does or does not satisfy the test?

The President may take action to block or unwind a transaction only when he or she finds that there is credible evidence that a foreign interest exercising control over a US business might take action that threatens to impair the national security of the United States, and provisions of other laws do not provide adequate and appropriate authority to protect the national security. Neither the statute nor the CFIUS regulations explicitly define 'national security', but the term is interpreted broadly.

The legal burden is not on the parties to show that a transaction does not present a national security threat, but rather the parties are obligated to provide CFIUS with all the information required by statute

and regulation and to answer all questions posed by CFIUS so that CFIUS may make a recommendation to the President. As part of the formal filing, there is an opportunity for parties to argue that a transaction serves a legitimate purpose and is therefore in the national interest, and parties in controversial cases usually meet with CFIUS and its member agencies to explain the purpose of a transaction and what safeguards are in place to make sure that there is no national security threat, but otherwise there is no legal burden on the parties.

17 To what extent will the authorities consult or cooperate with officials in other countries during the substantive assessment?

There is no specific provision in either the statute or regulations for consultations between CFIUS and officials in other countries.

18 What other parties may become involved in the review process? What rights and standing do complainants have?

CFIUS consists, by statute, of the following member agencies, all of which to some extent take part in consideration of those transactions being reviewed: the Treasury Department; the Department of Homeland Security; the Commerce Department; the Defense Department; the State Department; the Justice Department; the Energy Department; the Labor Department; and the Director of National Intelligence. The President may also appoint the heads of any other executive department, agency or office, as appropriate, on a case-by-case basis. A CFIUS national security risk assessment is based on confidential business information provided by the parties as part of the formal CFIUS process, as well as public sources and various government sources, including a classified national security threat assessment provided by the US director of national intelligence.

While there is no provision permitting competitors or customers to formally get involved in a review, the formal and protected CFIUS process does take place in a highly charged political environment in which members of Congress and local public officials regularly make their views known. For example, in some cases, members of Congress have introduced resolutions in opposition to CFIUS approval of a particular transaction. In others, members of Congress have introduced proposed amendments to the statute governing CFIUS in response to a CFIUS decision or a proposed investment. As part of this political process, competitors and other interested parties weigh in with members of Congress and express their opinions in the press. Newspapers write editorials about proposed investments, and local officials lobby Congress if they believe that there could be an effect on employment in their localities.

19 What powers do the authorities have to prohibit or otherwise interfere with a transaction?

Once the President determines that there is credible evidence that a foreign investor might take action that threatens national security, he or she is authorised by statute to take action to suspend or prohibit that investment by directing the US Attorney General to seek such relief in a US federal court.

20 Is it possible to remedy or avoid the authorities' objections to a transaction, for example, by giving undertakings?

CFIUS may condition clearance on parties entering into an agreement with the US government to address or mitigate national security concerns. FINSA authorises CFIUS or the lead agency for any particular transaction to negotiate such agreements, as well as set conditions for monitoring and enforcing them. The contents of such 'mitigation agreements' will vary depending on deal- and industry-specific concerns raised by CFIUS or government agencies. Typical mitigation provisions could include:

- the requirement that a US citizen be appointed as a security officer for the US business;
- periodic government reviews of export control and security policies and procedures in place at the US business;
- the isolation or ring-fencing of certain businesses or assets so that foreign persons do not have access to them;
- the requirement that notice be given to the government of changes in officers or top management at the US business;
- an agreement prohibiting foreign parties from having access to certain US technology; and
- an agreement to put in place a cybersecurity plan; an agreement that only US persons will sit on certain committees, such as security committees. CFIUS may also address through the terms of a mitigation agreement any increased risk if the foreign acquirer were to have a greater ownership interest in the US business.

CFIUS is most likely to impose such requirements in deals involving critical technologies such as telecommunications or energy, particularly when the US business is connected to the telecommunications or energy grids. While there are no limits to the sectors that can be subject to such an agreement, a decision by CFIUS to pursue a mitigation agreement must under the statute be based on a written risk-based analysis of the threat to national security of the proposed transaction, and the measures imposed must be believed to be reasonably necessary to address that risk. In cases in which there is a breach of a mitigation agreement, CFIUS may apply penalties of up to US$250,000 or the value of the transaction against parties in cases of intentional conduct or gross negligence, or may reopen the investigation in cases of an intentional, material breach of the agreement. A mitigation agreement may also include provisions establishing liquidated damages for violations of the agreement. Only a small percentage of all reviewed transactions result in mitigation agreements.

21 Can a negative decision be challenged?

Neither the decision by the President that there is a national security threat nor the decision to prohibit an investment is subject to judicial review. Most parties facing a potentially negative decision from CFIUS choose, instead, to request that their CFIUS notice be withdrawn, and such requests are generally granted. Parties may refile at a later date. As noted above, however, a federal court recently ruled that parties to a CFIUS review have certain due process rights during the process leading up to a presidential decision, including being given access to the unclassified information on which CFIUS is relying in making its recommendation to the President.

22 What safeguards are in place to protect confidential information from being disseminated and what are the consequences if confidentiality is breached?

All information submitted to CFIUS as part of the filing process is by statute considered confidential business information that cannot be released to the public and is not subject to disclosure under the US Freedom of Information Act. These protections also apply to information provided to CFIUS during the course of a withdrawal or as part of pre-notice consultations, even if the parties to those consultations do not ultimately file a notice. CFIUS may refer violations of these provisions to the US Justice Department. Convictions for wrongful disclosure can lead to fines or imprisonment under US law.

Recent cases

23 Discuss in detail up to three recent cases that reflect how the foregoing laws and policies were applied and the outcome, including, where possible, examples of rejections.

CFIUS reviews are confidential and neither the outcome nor the reasoning is released to the public, so any discussion of recent cases is limited to information that has been publicly discussed by parties or media accounts based on public or confidential sources.

Dubai Ports World

Although not a recent case, perhaps the best-known and most controversial CFIUS review of a foreign acquisition is, ironically, one that CFIUS actually approved, and which led to important changes in US law governing CFIUS reviews. In January 2006, CFIUS approved the acquisition of Peninsular and Oriental Steam Navigation Company, a British firm that ran terminal operations around the world and at six US ports, by Dubai Ports World (DP World), which is wholly owned by the government of Dubai. Coming about four years after the 9/11 attacks,

the approval of the transaction by CFIUS sparked intense media coverage and outrage among some members of the US Congress, who complained that they had not been consulted about the deal and that the deal should not have been approved because of the vulnerability of US port operations, and the fact that the acquiring company was a government-owned entity from the Middle East.

Resolutions disapproving of the CFIUS decision were introduced in both the US House of Representatives and the US Senate, as was legislation requiring the matter to be reopened. In the end, Dubai Ports World ultimately decided to divest the US port operations to a US company. That avoided a messy confrontation between the US Congress and the Bush Administration, but it did not put to rest the intense scrutiny of the CFIUS review process in either the Congress or the press. For the next two years, the US Congress considered a range of CFIUS reform legislation, including relatively draconian measures, ranging from the outright prohibition of certain foreign investments at US ports or involving US critical infrastructure, to moving CFIUS from the US Treasury Department, with its focus on foreign investment, to the US Department of Homeland Security, which was perceived by some in Congress as being more focused on national security than the Treasury Department. That two-year process ended with enactment of FINSA, which was generally viewed as a good compromise balancing the need to promote foreign investment in the United States with the need to ensure a thorough process for national security reviews. Dubai Ports World demonstrated that seemingly non-controversial investments can easily become embroiled in politics and, once the press takes notice, quickly spiral out of control.

The lesson for investors is that the CFIUS process should always be taken seriously, and in many cases both foreign investors and US targets need to consider the potential effect of the investment in the press and Congress before making a CFIUS filing.

First Gold Corp

In 2009, Northwest Non-Ferrous International Company Limited, a Chinese mining company ultimately owned by the Shaanxi Province government, proposed to acquire 51 per cent of First Gold Corp, a Delaware corporation that owns and leases mining exploration and development properties in Nevada. The transaction was notified to CFIUS, which undertook both a 30-day review and a second-stage 45-day investigation. Shortly before the end of the second-stage investigation, CFIUS reportedly informed the parties that it had identified serious and significant national security risks associated with the proposed investment. Specifically, CFIUS was concerned about the proximity of the First Gold properties to the US Fallon Naval Air Base and associated training facilities, as well as other sensitive and classified security and military assets CFIUS could not identify to the parties. CFIUS reportedly could find no acceptable mitigation to the risks posed by the transaction, including a reduction in ownership level or the exclusion of any of the properties at issue. CFIUS informed the parties that it would recommend that the President block the transaction if it were not abandoned. As a result, the parties abandoned the transaction. While CFIUS does not publicly discuss its decision-making process or rationale, it does set out in its regulations the factors it examines and the basic calculation it makes – weighing the threat posed by the foreign investor with the vulnerability of the assets. It seems clear that CFIUS had very concrete concerns about the location of the mining facility. What is less clear is whether the decision was equally motivated by the identity of the foreign investor, an enterprise ultimately owned by the Chinese government, and whether CFIUS would have decided differently had the investor not been a state-owned company or was from a country about which the US government has less heightened national security concerns.

Ralls Corp

Under FINSA, neither the findings of the President with respect to a national security threat nor the President's decision to block a transaction are reviewable by federal courts. In 2014, however, a federal appeals court ruled that this prohibition does not extend to the CFIUS review process. This ruling led to the settlement of a lawsuit brought against CFIUS by the Ralls Corp, a US corporation owned by two Chinese nationals affiliated with China's Sany Group. The settlement put off until a later date important issues involving the extent to which CFIUS will revisit its decisions based on court-ordered transparency and whether CFIUS has the authority to issue orders prohibiting implementation of a transaction prior to a decision by the President. The settlement does, however, indicate an aversion by CFIUS to have a court rule on the extent of its authority, and the case itself has opened a small crack into the heretofore less-than-transparent CFIUS process. It has also given foreign investors at least some ability to challenge the assumptions on which CFIUS decisions are made.

CFIUS had opposed the 2012 sale of companies developing four wind farms located in the state of Oregon to Ralls because of the proximity of the wind farms to US Navy restricted airspace. Based on this recommendation, the President concluded that the transaction posed a national security threat and issued an order prohibiting the transaction and requiring Ralls to divest itself of the project companies. Ralls and the company selling the wind farm sites had failed to initially file a notice with CFIUS. They only did so after closing the transaction, and after CFIUS informed Ralls that the US Defense Department intended to file a notice triggering CFIUS review if Ralls did not file first.

Ralls sued CFIUS, and in 2014 a federal appeals court, reversing a lower court's decision, ruled that the CFIUS process leading to the presidential order in the Ralls case violated Ralls' constitutional rights to due process, even though the Defense Production Act prohibits judicial review of presidential decisions in such cases.

Under the statute governing CFIUS national security reviews, the findings and actions taken by the President prohibiting transactions that threaten national security are explicitly not subject to judicial review. While noting that the law does, indeed, bar courts from reviewing 'final actions' the President takes in this regard, the appeals court said this did not extend to the reviewability of a constitutional claim challenging the process leading up to such presidential action. Nor did the court agree with the government that the process leading up to the President's decision in this case met the requirements of the due process clause. 'Due process requires, at the least, that an affected party be informed of the official action, be given access to the unclassified evidence on which the official actor relied and be afforded an opportunity to rebut that evidence,' the court concluded. The appeals court remanded the case to the US District Court that had originally rejected most of Ralls' arguments. As part of the remand, the appeals court also directed the lower court to review the legality of a CFIUS order issued prior to the final presidential decision. That order, among other things, required Ralls to cease all access, construction and operations at the wind-farm sites, and remove all items stored there. It also prohibited Ralls from completing any sale of the project companies without first removing all items, including concrete foundations, from project sites, notifying CFIUS of the sale and giving CFIUS 10 business days to object to the sale. The case was sent back to the lower court and in November 2014 CFIUS handed over more than 3,000 pages of unclassified documents to the court for review by Ralls, withholding only a few classified documents. The lower court ordered CFIUS to permit Ralls to rebut the evidence on which CFIUS relied and then to issue a new recommendation to the President based on that analysis. The court also permitted Ralls to challenge the CFIUS orders made prior to the President's decision, which impacted, among other things, Ralls' access to the wind farm sites they had already purchased.

The terms of the agreement have not been made public. The court papers state that, in light of the settlement, it is not necessary for CFIUS to issue a new recommendation to the President in this matter. It also has been reported that the settlement permits Ralls to sell the wind farm properties to a company that had previously been rejected as a potential buyer by CFIUS. As such, the settlement can be viewed as a victory for both sides. CFIUS has avoided a court decision on whether it has the legal authority to issue orders prior to a presidential decision, as it did in Ralls. It also saves CFIUS from having to possibly reverse its earlier decision, something it has never done. For Ralls and Sany, the stigma of having its acquisition of a US business rejected by CFIUS has been partly erased and it has paved the way for other Chinese companies to challenge the basis on which a CFIUS recommendation is made. In the long term, this case could change the way CFIUS explains its decisions and concerns to parties and what evidence it has to support its views, enabling parties to challenge such conclusions. It could also have an impact on CFIUS's leverage in forcing parties to accept mitigation agreements because CFIUS will more likely be required to explain on what basis such measures are needed.

Aixtron SE

The most significant event in this area over the past year was the December 2016 decision by President Obama to block the acquisition of the US subsidiaries of German semiconductor-equipment supplier AIXTRON SE by Chinese investors, the latest US action to limit Chinese access to US semiconductor technology.

The investment was made through Grand Chip InvestmentGmbH, a German special purpose investment vehicle ultimately owned by Chinese investors. These include Fujian Grand Chip Investment Fund LP, a limited partnership organised under the laws of the People's Republic of China, as well as investors owned by the Chinese Government. Based on the recommendation of CFIUS, the President issued an executive order blocking the US component of the transaction prior to closing, finding that there was 'credible evidence' that, by acquiring control of Aixtron's US subsidiaries, Fujian Grand and individual Chinese investors involved in the transaction 'might take action that threatens to impair the national security of the United States.' The President ordered the parties to 'fully and permanently abandon the proposed acquisition of Aixtron' within 30 days, and authorised the US Attorney General 'to take any steps necessary to enforce this order.'

Aixtron SE a global company headquartered in Germany, designs and manufactures equipment for the semiconductor industry, including systems used to build compound semiconductor materials used in a range of high-tech industries. Its products include Metal-Organic Chemical Vapor Deposition (MOCVD) systems, which have both civilian and military uses. These systems are also the focus of research and development activities by the US Army.

In its press release announcing the President's decision, the US Treasury Department, which chairs CFIUS, focused on the fact that some members of the consortium were owned by the Chinese Government, as well as the potential use of Aixtron's technology for military purposes. 'The national security risk posed by the transaction relates, among other things, to the military applications of the overall technical body of knowledge and experience of Aixtron, a producer and innovator of semiconductor manufacturing equipment and technology, and the contribution of Aixtron's US business to that body of knowledge and experience,' Treasury noted in its statement. 'The proposed acquisition was to have been funded in part by Sino IC Leasing Co., Ltd., a financing provider belonging to China IC Industry Investment Fund, a Chinese government-supported industrial investment fund established to promote the development of China's integrated circuit industry.'

The Aixtron decision is significant for a number of reasons.

First, it represents only the third time that the President has issued an order prohibiting a foreign acquisition of a US business, based on a recommendation by CFIUS. As noted elsewhere in this chapter, in 2012 President Obama ordered the Ralls Corp, a US corporation owned by two Chinese nationals affiliated with China's Sany group, to divest its interest in US companies developing four wind farms located in the state of Oregon because of the proximity of the wind farms to US Navy restricted airspace. In 1990, President George H. W. Bush ordered the China National Aero-Technology Import and Export Corporation ('CATIC') to divest its interest in MAMCO Manufacturing, Inc. ('MAMCO'), a Washington corporation that manufactured parts for commercial aircraft. CATIC performed export and import functions for the PRC Ministry of Aviation.

Second, in all three blocked transactions, the acquirers were Chinese, another sign of the overlay of geopolitical issues and CFIUS national security determinations. While many additional CFIUS filings have been withdrawn by the parties due to the opposition of CFIUS, the above three involving China are the only ones that have resulted in presidential orders.

Third, the decision underscores the broad view CFIUS has of its jurisdictional reach. The Aixtron transaction was a deal between a Chinese investor and a German company. CFIUS may assert jurisdiction over the acquisition of one foreign company by another, but only to the extent there is a US business involved in the transaction, such as a US subsidiary or branch office. The regulations governing CFIUS define a US business as 'any entity, irrespective of the nationality of the persons that control it, engaged in interstate commerce in the United States, but only to the extent of its activities in interstate commerce.' In the executive order, President Obama took a very broad view of what this means in the Aixtron case, describing the relevant US business as follows: 'The U.S. business of Aixtron consists of AIXTRON, Inc., a California corporation, the equity interests of AIXTRON, Inc., and any asset of Aixtron or AIXTRON, Inc. used in, or owned for the use in or benefit of, the activities in interstate commerce in the United States of AIXTRON, Inc., including without limitation any interest in any patents issued by, and any interest in any patent applications pending with, the United States Patent and Trademark Office (collectively, Aixtron US).'

Finally, there is more at play here than just the usual US-China tensions. Chinese investments in US high-tech industries, especially in the semiconductor sector, have become a lightning rod issue in the United States recently, not only at CFIUS but also in the US Congress and in US political discourse. This has been both a response to a highly publicised Chinese plan to subsidise its semiconductor industry up to $20 billion, and to the potential military uses of semiconductor technology. In addition to the Aixtron transaction, a number of attempted Chinese investments in the US semiconductor sector have failed due to concerns raised at CFIUS or to the reluctance of US companies to accept Chinese bids due to fears of rejection of the transactions by CFIUS.

This is a complex issue for the US Government and US companies doing business in China, as China has become a major market for semiconductors used in a range of electronic industries involving US companies. It remains to be seen how all of this will play out under the Presidential Administration of Donald Trump, who has been a vocal critic of China in terms of both national security and international trade.

SHEARMAN & STERLING LLP

Robert S LaRussa **rlarussa@shearman.com**
Lisa S Raisner **lraisner@shearman.com**

401 9th Street, NW
Suite 800
Washington, DC 20004
United States

Tel: +1 202 508 8000
Fax: +1 202 508 8100
www.shearman.com