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When M&A Meets National Security: New Laws Affecting Private Equity, Sovereign Wealth and Investments in U.S. Companies

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The Committee on Foreign Investment in the United States (CFIUS or Committee) has broad authority to review foreign acquisitions of U.S. businesses, and certain other transactions, on national security grounds. A newly enacted law, the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA), represents the most significant change to CFIUS's review framework since its creation three decades ago. Although prompted primarily by national security concerns with Chinese investments, FIRMMA will affect investments by all non-U.S. investors, including investments that may have flown under the radar in the past. Changes will be especially important for private equity funds with sovereign investors and other investment vehicles involving non-U.S. minority investors. The changes reflect a trend across developed markets for greater scrutiny of investments by non-citizens.

The enactment of FIRRMA in August launched a major rule-making process and staffing expansion for CFIUS agencies. While extended timelines for the CFIUS review process entered into force immediately, key jurisdictional and prior approval provisions will phase in only after the issuance of regulations and expansion of staff, processes that will likely take over a year. In the meantime, CFIUS is authorized to implement "pilot" programs implementing specific FIRRMA provisions — CFIUS would be required to provide at least 30 days public notice prior to the commencement of any such pilot programs. Meanwhile, the administration has initiated a related regulatory process of classifying and imposing licensing requirements for exports of "emerging" and "foundational" technologies. This effort could affect cross-border transactions more broadly, including outbound investments from the United States.

Mandatory declarations

From an acquirer/investor perspective, FIRRMA's biggest impact is found in the new "mandatory declaration" provision. For the first time, investors affiliated with non-U.S. governments (including sovereign wealth funds) and investors targeting certain types of U.S. businesses designated by CFIUS will be required to file a short (about five pages) notification of certain proposed investments. After receiving a declaration, CFIUS will have 30 days either to approve the transaction or to require a full CFIUS review.

Declarations will be mandatory for:

- Investments by non-U.S. persons in which a non-U.S. government has a "substantial interest", including sovereign wealth funds. FIRRMA instructs CFIUS to define the term "substantial interest" to clarify what type of influence from a non-U.S. government would fall within scope. An investment with less than a ten percent voting interest will not be considered to constitute a "substantial interest". In addition, declarations may be waived by CFIUS with respect to non-U.S. investors that demonstrate that their investments are not directed by a non-U.S. government and that have "a history of cooperation" with CFIUS.

- Investments by any non-U.S. persons in certain types of U.S. businesses that CFIUS will delineate in the regulations, likely including businesses involved in critical infrastructure, critical technologies including "emerging technologies", and handling of sensitive personal data of U.S. citizens. This provision will impact investments in the technology sector. Private or seed investments by non-U.S. persons that might have flown under the radar previously may (depending on the language of the regulations) require declarations to CFIUS.

Exceptions to the mandatory declaration requirements

FIRMMA creates an exception to the mandatory declaration requirements for non-U.S. person investors that serve on advisory boards or committees of investment funds that are managed exclusively by a general partner/managing member who is a U.S. person if, among other requirements, the non-U.S. person investor does not have the ability to control investment decisions of the fund or access to material nonpublic technical information as a result of its participation on the advisory board. But because the exception will apply in the context of private equity investments meeting the specific parameters set out in FIRRMA, counsel to U.S. target companies may note a change in how private equity investments are structured. For example, many commonly used investment structures fall outside the scope of the exception - e.g., in funds-of-one, separately managed account, or certain co-investment vehicles, investors generally do not put advisory boards in place and may retain direct influence over the structure.

Other changes

FIRRMA amends the CFIUS process in a number of other ways. While CFIUS previously had broad authority to review investments that could result in a non-U.S. person's control of a U.S. business, the new law expands CFIUS's authority to review, subject to certain limitations:

- non-controlling foreign investments in a company involved in critical infrastructure, critical technologies, or that collects sensitive personal data of U.S. citizens; and
- the purchase, lease, or concession by or to non-U.S. persons of real estate that is located within a port, or is proximate to a "sensitive" U.S. government property even if the real estate is not associated with commercial activities.

In terms of timing, FIRRMA extends the initial review period from 30 to 45 days, and adds a possible 15 day extension to the investigations phase (i.e., an investigation phase may take up to 60 days). FIRRMA also clarifies CFIUS's authority to block transactions or impose conditions during a review process or when parties withdraw.

For the first time, CFIUS will be authorized to collect a filing fee. The fees will be determined by regulation, and will be based on the value of the transaction — they will be capped at the lesser of one percent of the value of the transaction, or US$ 300,000.

Of broader importance, FIRRMA authorizes CFIUS to disclose to a U.S. ally or partner information arising from a CFIUS process in order to advance the common national security interests of the U.S. and that other government. This new authority will facilitate greater cooperation between regulators in the U.S. and partner countries.

Going forward

These changes may influence who invests in U.S. companies, and how investments are structured. The addition of mandatory declarations — that is, prior approvals — may affect a number of key investors in private equity acquisitions and ultimately result in greater scrutiny of a broader array of transactions. CFIUS's expanded reach also does not occur in isolation: investors targeting businesses in Europe and elsewhere may find their investments similarly subject to review on national security grounds.