Center for Strategic and International Studies

“Press Briefing: CFIUS Recommendations for the Next Administration”

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COLM F. QUINN: All right, folks. Thank you so much for coming in this morning. I don’t want to speak too long. I’m Colm Quinn, our – I’m our deputy director for strategic communications. And today we’re going to be talking about a report that our international security program has just put together on CFIUS and the how the administration – the new administration should be handling it.

To my left is Andrew Hunter, who’s the director of our defense industrial initiatives groups, DIIG, and a senior fellow at CSIS. And another co-author is John Schaus, who is a fellow in the international security program. They’re going to take you through a short presentation on the report, and then we’ll want to open it up to questions. We will be transcribing this for you guys, so if you can, please use the microphones in front of you. And otherwise, let’s have a lively conversation.

Q: When will that transcript be ready?

MR. QUINN: By COB, hopefully by lunchtime.

JOHN SCHAUS: Thank you, Colm. Good morning, everyone. As he said, I’m John Schaus. I’m a fellow at the International Security Program. And it wouldn’t be a DOD-style briefing without some sort of slides. We will keep it pretty brief. I think we’re at eight total.

Just very quickly, running through the study background, how did we end up taking on a pretty arcane topic in kind of defense issues? Basically, we started this study because FINSA, the pertinent law that applies CFIUS, was passed in 2007 and came into effect in 2008. So six years into this new process there was enough data to start looking at what was actually happening and how it was working, and there was enough people with – there were people – the body of people with enough experience was great enough to have real conversations with a diversity of views.

Second, there was a few pockets of folks who thought that following the government shutdowns in – early in the Obama administration, that maybe there were some problems with CFIUS that really needed to be looked at and solutions found. And so took on this project with that in mind, as a way to think about how to improve the process.

ANDREW HUNTER: I just wanted to add a little insight there, that the issue with the shutdowns is that – CFIUS runs on very tight statutorily-specified timelines. So when the people doing the work are not able to work because of the shutdown, but the statutory timeline doesn’t change, that that creates an issue.

MR. SCHAUS: Thanks, Andrew.

And then, just last, on methodology, we did a pretty standard think tank methodology. We did basic research looking at literature and published documents. We reached out to practitioners and folks with experience for interviews. And we pulled together a working group to really kind of bounce ideas and try and help make sure we have the issues right.

So moving straight into our findings, the first and probably most important finding is the CFIUS is working, which wasn’t necessarily what we assumed going in, but it was an important finding for us. And what do we mean by, it’s working? So first, the clear timelines. Andrew mentioned the statutorily established timelines. Surprisingly, those were appreciated by all parties. People in the government found that to be a helpful focusing function to make sure that attention didn’t
drift and wander to other issues. And private sector participants liked the clarity and the certainty that whatever the outcome, you knew how long the process would take.

Second, that CFIUS is a voluntary process. And so parties who are entering a transition choose to file or not. And that helps moderate the burden both on the private sector and on the review process. However, there’s a government-initiated option so that if something comes to light that wasn’t filed that needs an investigation, that avenue is still open. So overall, we thought the CFIUS is working.

Second, there’s a desire for regular communication between stakeholders. And what does this mean? CFIUS filings over the last couple of years have come from 22 different Commerce Department-identified sectors. And as a result, the range of individuals and the range of firms who may be involved in a CFIUS transaction is pretty broad. And so ensuring that there is adequate opportunity for outreach, both from the government side to the private sector and for feedback and input from the private sector to the government on what’s working and maybe ways to improve the process is important and would be desired.

Third, CFIUS regulations are understood unevenly. So for those of you who like digging into the Code of Federal Regulations and published documents –

MR. HUNTER: Who doesn’t?

MR. SCHAUS: It’s a very exciting thing to do at 11:00 at night if you’re having a hard time sleeping. But there’s pages and pages of regulations on how the process should work, including a number of examples. But what we found in our working group discussions is even amongst people with a pretty high level of experience with CFIUS, there were different understandings of these regulations of what was necessary, what was important, and what was optional.

And then the last finding I would highlight here is that the risks in the process are potentially increasing. The ease in movement of capital, increasingly complex ownership structures, and the growing potential for state-owned or state-directed entities to engage in commercial activity all increase the risks to monitor when reviewing investments for national security risk. So transactions are becoming more complicated, potentially more opaque, governments around the world have more opportunity to engage in commercial practice than they used to. And this is creating new types or new levels of risk for national security.

So with that, move to some data. There are more expansive versions of both this chart and the next in the written report in front of you, or available online. But to highlight a couple of things that we thought were most important here – so this data captures all CFIUS filings from 2008, the first year after FINSA was passed – the Foreign Investment National Security Act – through 2014, which is the most recent year for which data is available. And what we see is that there are – there were 782 cases filed with CFIUS. So 782 transactions that were reviewed. Of those, only 267 went into a second kind of review period, a more extensive review period, called the investigation period.

So CFIUS starts with a 30-day period. There is a potential for a 45-day deeper investigation period. And then the last phase, potentially, is a 15-day period for the president to review a recommendation and issue an order on a case. So the maximal extent of a CFIUS review is 90 days, from start to finish. So this table shows 267 went into investigation. Of all the 782, only 50 were withdrawn and then refiled. So a very small number actually had to kind of recirculate to continue in the process.
Only 52 were subject to mitigation measures. These – mitigate measures is a technical term, strangely enough, that involves an agreement between the parties to the transaction and the government, steps that the parties will take that the government can monitor and audit to ensure appropriate controls are in place so that foreign entities that are of potential concern don’t have access to items that are of concern, or the processes, or the intellectual property that are of concern of the acquired U.S. firm.

And then the last column here is presidential action. You’ll note, of 782 filed cases since 2008, only one received presidential action. It was a case in 2012 where a firm co-owned by two Chinese individuals, sought to acquire wind farm operations in Oregon, and the president denied that transaction.

MR. HUNTER: And then there’s the –

MR. SCHAUS: And then there’s this case, this – which can’t be reflected in this data and probably won’t be until late 2018, based on normal reporting timelines. But we can talk about that more in the discussion.

And then one last data chart, this shows number of filings by filing country per year since 2008. It’s the top five countries. So you’ll see U.K. in green, China in red, Japan in Blue, Canada in orange, and the gray-black is France. So what’s interesting to me in that is of the top five countries that are reviewed in CFIUS, three are NATO allies. One is Japan, which is the U.S.-Japan alliance. And then China is the fifth country, the second-most prevalent.

So what this tells me is the idea that CFIUS is targeted at any particular country doesn’t bear through. When four of the five are close treaty allies of the United States, that tells me that this is a robust process for all foreign countries.

Q: John, can you just touch on how country of origin is established on some of these – as you discussed in the risks – some of these entities are technically from one country, but the ownership interest may be from multiple countries?

MR. SCHAUS: That is – I was hoping you wouldn’t ask that question. (Laughter.) It’s a complicated process. And I don’t know exactly how it’s established, but I believe that it is based on the assessed ownership of the acquiring firm. So in many cases, like the case we saw this past week, it’s the acquisition of a German firm by a German firm, where there is a U.S. subsidiary and a Chinese parent involved that causes the United States to get involved. It is not necessarily that there is an individual from that country. And is that the clarity you’re looking for?

MR. HUNTER: Yeah. I would just maybe add to that, you know, that one of the things that CFIUS looks at is foreign ownership control interest. Ownership obviously would suggest that the country of origin is one of these countries on the chart. But there’s also a control and interest. And a lot of the cases may involve – or the case that was in the newspaper this morning – you know, was a case of interest rather than necessarily ownership.

Q: So what if it’s a – say it’s an VC fund and it’s getting money from a country where the fund is based in the U.S. How does that show up there?
MR. HUNTER: We’re not 100 percent sure. It’s the government’s data. But my – I think it’s highly likely that it would show up, and that – for the case that’s in the papers this morning, where it’s technically a U.S. venture capital firm that is doing the acquisition, is it would show up as a – well, that wouldn’t show up in the data as a U.S. firm, because it wouldn’t be foreign – (laughs) – it wouldn’t be foreign investment if it was a U.S. firm.

Q: So we’ll wait and see?

MR. HUNTER: Yeah. So, I mean, I guess the question is what triggers the CFIUS review will be the investment that is overseas in nature. So it’s a great question. We’re going to have to drill down more on that. We’ll follow up with you guys if we can get an answer to that.

MR. SCHAUS: So last substantive slide here, recommendations. Four recommendations. First, sustained dialogue between government and parties. What this means is as written CFIUS is a very, very structured process. And one could interpret the regulations to limit the opportunities for the parties to the transaction to interact with the reviewing offices within government, into a very stilted kind of conversation. And both former government officials and private sector representatives know that the process works best when there is an opportunity for – they called it informal dialogue.

So whether it’s a pre-filing discussion of, you know, this is the kind of transaction we’re looking at, is this going to be a problem? What kind information will you need, basically to expedite the preparation of documentation? And then, throughout the process, so that as the government identifies potential risks it can go to the parties and say, you know, without prejudicing the outcome of the case here, the kinds of risks we’re looking at, what kinds of resolution can you identify to mitigate this risk, and to begin that conversation earlier.

Second recommendation, hold a regular industry day. This is directly ties to our finding where regular interactions between government officials and the interested sectors or interested industries is important to really help make sure there’s a level playing field, acknowledging information for companies that in practice don’t often engage in CFIUS, right? It’s a one-time shot for most companies when they’re acquired, so they don’t have a depth of expertise.

Third, periodically update CFIUS guidance. And this gets to the issue that the application of the regulations evolves over time as the market and the transactions evolve, and an updating of the guidance would really help to (level set ?) information and awareness of how the process is working.

Our last recommendation is to enhance risk management practices and monitoring of emerging concerns, in particular ensuring CFIUS is resourced in terms of personnel, technology, and information, to investigate increasingly complex and sometimes opaque ownership structures. We’ve seen an increase in these kinds of activities, both in terms of the case that the president review indicated last week, in terms of the case Andrew mentioned this morning where a U.S.-based venture capital firm is seeking to acquire another U.S. firm, but there’s questions about where its funding is actually derived from. So these are the kinds of questions that CFIUS needs to have the resources to make sure it’s on top of.

Final slide, conclusion, takeaways. CFIUS is working, all right? The process is maintaining a good grasp, we think, on what is national security and preserving government’s role to protect national security, while ensuring that it plays as small a role in market transactions as possible, and that key to that is maintaining a specific focus on national security concerns. All right, so there are – there are
calls for CFIUS to be expanded to look at every possible transaction. I think in our view that is not going to be helpful to achieving the actual goals of preserving national security.

So with that, I’ll turn it over to Andrew for any final thoughts, and then have a conversation.

MR. HUNTER: Yeah, I guess on final thoughts I would say that – maybe just get a little more depth on the point about updating the regulations, which sounds like a very benign point. But the issue there is there has been some evolution in what the government has been focusing on in reviews over the time period, which is appropriate because the market changes – the nature of what’s happening in the market changes. So that is the right thing to do, for the government to be smart and to try to keep up with what’s happening in the market.

But as John indicated, what we discovered is even among the practitioners who were most experienced in this, in some cases there was doubt about, you know, what qualifies a problem, what doesn’t qualify a problem. The case that did go to Presidential action that John mentioned, the Ralls case, was an issue of proximity to sensitive U.S. government facilities. And that hadn’t been an issue that had been high on the radar screen until that case came up. All of a sudden, when you get to a presidential action of which there had been a total of three in multiple decades.

Now of course all the people who do this say, well, what counts as proximity? What are the sensitive facilities you’re worried about? That’s something that’s hard to spell out in regulations, because it’s something that’s inherently probably going to shift a bit over time. But it is a great thing for this informal dialogue that John mentioned, being a real key so that the government can let people know in an informal way, you know, not hard and fast rules, but these are the kinds of things that we are likely to be concerned about, that we should talk about. And in most cases, most beneficially, talk about before filing is actually made. It also helps to determine what filing needs to be made.

The other trend that obviously is highlighted, you know, somewhat fortuitously this morning, is this issue of the complex ownership structures, and how – you know, where the money is actually coming from is becoming a harder and harder thing to analyze than it may have been in the past when the predominant deal was a company acquiring another company, and ownership of the company was straightforward. And it’s also been true in the last decade or so that there are a large number of investment vehicles, that have gotten quite large, that are directly state owned and run. And so that’s a new dynamic on the market as well.

Again, our finding is that CFIUS is able to accommodate these things, but it definitely drives this need for there to be a lot of continuous dialogue between the government and the practitioners and industry who focus on it.

MR. SCHAUS: I think we’re ready for questions.

Q: Eric Kulisch, American Shipper Magazine.

I guess I’ve got a couple questions. What – this was a retrospective look. Looking forward with the new Trump administration how do you see them either using the CFIUS process or do you see more companies voluntarily, you know, applying or going through the CFIUS process ahead of time?

MR. HUNTER: Yeah, that’s a great question. I think a lot of it – you know, they’ll be looking for early signals from the new administration about how it’s going to approach things. Obviously with
President Obama having done two presidential action, and there had only ever been one by any other president, you know, I think this administration has been perceived as being fairly rigorous when it comes to CFIUS reviews. But they’ve also, you know, approved a lot.

You also see some commentary specifically from business interests in China, where they feel, I think, that they’ve gotten more scrutiny than they wish they had. And so there’s been some sense that perhaps reviews of Chinese investment are more frequent than others. Again, John – you know, the data doesn’t necessarily bear that out, but there’s certainly – there’s certainly that perception out there.

So I think people will be looking for early signals with the new administration, with the new secretary of Treasury, we’ll see. They’ll probably be asked about CFIUS in the confirmation, so that’ll be the first – you know, the first signal as to how he’s thinking about that as he goes through the confirmation process. What do they do in the first year in terms of is there more mitigation being required, are there more reviews being held, are more things going to the – to the investigation phase? And I mean, I guess if I were forced to guess, my expectation would be that it might – you know, that it might step up, both because the Trump administration is I think somewhat sensitive to foreign investment based on their rhetoric, and then secondly because of these trends that we identified in the report, which is there’s just more of this happening. And particularly Chinese investment arms have been very aggressive at doing foreign acquisition, including acquisitions in the U.S. But as the case that’s in the paper this morning, it doesn’t even have to be an acquisition in the U.S. You know, the economy is so globally integrated, you know, that a German company, a Japanese company, most of these companies, they’ll have some U.S. component or interest, and that can give rise to a CFIUS review.

Q: So, along those lines, was there – given the rhetoric of the president-elect towards China policy and trade, I mean, could CFIUS be used as a – do you see it being used as a lever, or blocking or making some of these transactions more difficult as part of an overall policy towards China? And then was there – was there a recent study by another think tank saying that, for the time being at least, all Chinese or all state-owned companies trying to acquire in the U.S. should be, you know, blocked through CFIUS? I can’t – thought I recalled seeing something like that.

MR. HUNTER: I haven’t seen that, but that’s not to say it’s not out there.

Q: Yeah. My memory could be bad, too, so don’t quote me.

MR. HUNTER: (Laughs.) Or it could be a congressman or someone calling for that. You know, you get a – you get a wide diversity of views.

As to, you know, how would the CFIUS process be used by the new administration, I mean, one of the things that really emerged from our study – and John can correct me if he has a different take on this – is, you know, the process is designed essentially not to be weaponizable or not to be weaponized, at least very easily. In other words, you know, it’s a – it’s a very time-limited process. It’s a voluntary filing process. So it’s not – it doesn’t readily lend itself to saying, hey, this is one way we’re going to inflict discomfort on a specific foreign country or a specific set of foreign entities. That’s not to say it’s impossible to do that, but it doesn’t lend itself readily to that.

It also would create quite an issue in the process because – and John touched on this – there’s not – there are not dedicated resources for doing CFIUS reviews. So when the government gets into a(n) intense, you know, 30-day diving deep into the financial structure of a company and the people –
the individuals who are running that company who may have problematic backgrounds from a national security perspective, which happens from time to time – you know, that’s a – that’s a resource-intensive effort, and there is no dedicated resourcing to do it. So the offices that do that, you know, they have to kind of stop everything that they’re doing in their normal day job, go run off and do this CFIUS task. And they – you know, there are dedicated personnel for CFIUS, but they’re not – they’re not great in number. So, to the extent that anyone was interested in using CFIUS to do, you know, kind of the – to pursue, I guess, a policy agenda, if you want to call it that, you know, that’s going to run up against resource constraints really quickly, which would mean either you’d have to sort of stop doing the other reviews or do them less intensively, or add more resources to the offices that do these CFIUS reviews.

Now, we looked a little bit at the issue of, you know, could you come up with a resource mechanism for CFIUS that would make it a little easier to do these expedited reviews. And also the piece that sometimes gets ignored is, when you have these mitigation measures, who’s actually following up to make sure they’re getting followed. And that’s a potential vulnerability in the system that, again, there’s not dedicated resourcing to look at these mitigation agreements and make sure that they’re being followed.

You know, there are – you know, essentially, companies would not follow them at their own risk of potentially pretty significant consequences if they didn’t follow them and then – and then it was discovered, but there is a possibility of resourcing the mitigation reviews more than they are today. But I think it would mostly be an issue of resources.

MR. SCHAUS: If I can add just a couple of quick things to what Andrew said, on the compliance/enforcement resourcing, there is a – there is resourcing. I don’t want anyone to take away the idea that there’s no resourcing. But it’s not tied to the number of mitigation measures that have been implemented. And so there’s a(n) imbalance in that part of the process.

And then, to his comment about the potential that CFIUS could be weaponized, one key thing to note about how CFIUS works is it is designed to work in a vacuum. So if there is any other relevant law or provision that would, you know, apply to a situation, CFIUS cannot be applied to that situation. So it has to be in one where there is no other way to look at, examine, consider, or protect the national security of the United States. Which is the second part, which is CFIUS has to be focused on national security. So two elements: operating where no other law or provision operates; and, two, focused on national security. And so, you know, applying it carte blanche to a country of origin or a sector, most sectors at least, gets very complicated because of those two key elements of CFIUS.

Q: Hi. (Name inaudible) – China Daily. I have several questions, so just – I think I’ll just say it together.

I mean, first, I mean, how often CFIUS changing, I mean, revise its guidance? I mean, so this report, could it be used, I mean, quickly by CFIUS?

Secondly, I mean, you give the charts, China among the five. But how industry-wise? Maybe the British were buying more defense industry company and Chinese – I found, I mean, they are filing unnecessary, like you are buying pork company, you are buying a movie chain. So that’s not really national security, to me. But they become so nervous because they are from China, so they kind of – well, it’s like self-censorship. They’ll say let’s file, I mean, regardless. So how this is the case, I mean, regarding especially China, I mean?
How sort of Congress is going to affect, I mean, this CFIUS operation? Obviously, we see years ago Congress has this view naming Huawei and ZTE as sort of a national security threat, but you don’t see that in Europe, other parts of the world, I mean, where ZTE and Huawei are received very well, I mean, in their investment. But their investment here is denied or whatever. I mean, it’s multiple difficulties. So, yeah, I think that’s maybe for the time being.

And also, the presidential action case, I mean, the only one regarding China, why, I mean, this takes presidential action, I mean, cannot be resolved by CFIUS? I don’t know, I mean, how that works.

MR. HUNTER: Yeah, let me start with the second one and – but John can correct me if I get it wrong. This is maybe an unfortunate analogy, but the CFIUS process can be a little bit like a game of chicken – you know, who’s going to blink first. You know, chicken is a game where two people are driving at one another, and whoever turns first loses. And so, depending on the risk tolerance of the firm you know, they can – they can sort of say, well, is the president really going to take action?

We know that the bureaucracy – you know, they get clear signals through the process. First when an investigation is triggered, secondly as the investigation proceeds, they get, I think, fairly – in most cases fairly clear signals from the bureaucracy that says our concerns are not being addressed; you know, this is not – we’re not finding a way to mitigate the national security concerns that we’ve identified. And so generally speaking I would argue, if something goes to presidential action, it’s essentially because the company has taken a gamble to say, well, you know, we think you’re wrong, and we dare you to do something about it. Because the company always has the option to say, OK, we know we haven’t addressed the government’s concerns; we’ll withdraw, we’ll refile, we’ll modify the transaction, we’ll agree to greater mitigation. So, when it goes to presidential action, that’s not just a government-only decision; that’s a – you know, that’s a two-part decision that’s being made on both sides as to are we going to push it to the end of the process or not. And it is very rare. It’s rare on – both sides, I think, are somewhat reluctant to go that route, but occasionally it does happen.

The first half of your question was, you know, about, like, the meat company and the theater company. You know, I would say that national security can show up in some surprising places. So, you know, I think in the case of the theater company, OK, it’s a movie – you know, it’s a movie chain; how can it possibly be of interest? Well, almost every U.S. military base has a movie theater on it, quite a number of them. So, you know, I think the issue becomes – OK, maybe it’s not an issue, but they chose to file. Of course, it’s voluntary that they, you know, chose to file. I think that was one where the government required them. Now, there may have been some back and forth before they made that decision where someone said, hey, you know, what’s the harm? If it’s not going to interrupt the transaction, what’s the harm? Because what companies get, if they file and they are – and the government doesn’t take any action or doesn’t propose any mitigation, is they have then safe harbor. So they get a protection under U.S. statute from later – down the road from suffering any consequences because, hey, you didn’t tell us that you were engaging in this transaction. They get safe harbor. So there’s a benefit to the company to file in cases where, OK, maybe this is or isn’t a concern. There’s an incentive to file and get the review.

You know, I’m not as familiar with the – with the meat-packing case. I don’t think that – that one didn’t go to investigation, I don’t believe.

MR. SCHAUS: I don’t even know if it went through CFIUS.
MR. HUNTER: It may not have ultimately gone – I think it did go to CFIUS.

Q: They filed, I think.

MR. HUNTER: I think it did, but I don’t think it went to investigation. So I think – you know, obviously when you’re talking about, you know, companies that may have investments in biotech, you know, biotech has the potential to raise national security concerns in certain scenarios.

MR. SCHAUS: If I can throw just a couple of additional points onto what Andrew said, completely agreeing with everything he said. One of your questions, sir, was about why is the president getting involved. Because of the law. The law says, if the bureaucracy and the parties can’t work it out, only the president has the ability to deny a transaction, all right? So it can be approved at relatively low levels, but it can only be denied by the president. And so that gets to Andrew’s point of the game of chicken, right? Nobody wants to send things to the president. That’s never a good day, right?

MR. HUNTER: If you’re in the bureaucracy.

MR. SCHAUS: If you’re in the bureaucracy, but even if you’re a company, because then there’s a lot of press associated with a presidential decision. So that reluctance is there, and it’s probably a good mechanism in the system. But only the president can deny.

And then your question about China and self-censorship and related sectors, and Huawei, ZTE, other parts of the world, I can’t speak for any country’s policies. I’m not a government official. But I would say that every country has its own opportunity to define national security for itself. And the United States has had a pretty consistent approach to certain firms and their involvement in the United States, and other countries can take another approach.

Q: Thank you. Sandra Erwin with National Defense Magazine.

What’s sort of been the process with government contractors? I mean, is that an automatic showstopper as far as do they – are they required to always spin off their government contracting business to keep it isolated? And given that so many of the countries that are buying companies are allied countries, are they still making it very difficult for them? Thanks.

MR. HUNTER: Yeah, I guess – I guess I would say, to answer the last part of your question first, I think very difficult. And my opinion would maybe be not correct; I would say it’s not very difficult if you’re an ally. But I think it might be fair to say it’s difficult. (Laughs.) So it’s the modifier, maybe, that would be in dispute. It’s difficult. Is it very difficult? I would say probably not. There might be some of our ally/partner friends who would say it’s pretty difficult.

And there was some back and forth about, again, for companies that are known from allies and partners who are close allies and partners, you know, could the process be streamlined in some way? The way the process is established, it’s already fairly streamlined. So we didn’t see an obvious way to say, OK, these are the companies that sort of are automatic greenlights. I don’t think the government is going to go to an automatic greenlight because of the complexity of these ownership structures. And you find even with allied partners and nations, you can have individuals in a transaction who raise – who raise national security concerns. And that’s, you know – that’s just being realistic.
So I think – I think it is difficult. It’s not necessarily – we didn’t see that it was – there was a clear, you know, OK, here’s a practice that should be adopted that’ll make it easier. But there could be – there could be opportunities when a company is well-known to the government to say, OK, maybe we’re not going to need to go as in-depth when we just did it with them last year if there’s another acquisition that comes along.

The first half of your question was on?

MR. SCHAUS: Required spin-offs.

Q: On the, yeah, do they have spin off their gov contracting business.

MR. HUNTER: It really depends. I mean, there is really a huge suite of possible mitigation measures, or of course in some case there may be no mitigation. But I would say if a company has government contracts and those contracts are important to national security in some way or another, usually I think there probably is going to be a mitigation measure. You know, they can – they can be – take control through a proxy, which limits the parent company’s ability to give any direction to or get insight from the U.S. subsidiary. They can have a – you know, almost one of the easiest things they can do is have a security committee established on the board of directors that lets them – you know, that basically has someone advising the owners to say these are the things you can’t do because you will end up violating U.S. law. And so there’s a whole range of things they can do.

And as John mentioned, you know, there are other processes aside from the CFIUS process that are designed to protect U.S. government information. And so for companies that engage in classified work with the Department of Defense or other government agencies, there is a national interest determination, a NID, that is – that has to be done if that contract is transferred from one entity to another. And so, if a foreign company is acquiring a U.S. company that has classified U.S. government work, they’re going to need to get a NID. And in most cases, the NID will then say, OK, here’s what you have to do to protect us. And it may well be that they have to – they have to sell it, spin off the work. Again, that would be the case where a proxy entity might be more likely.

Q: What’s been the trend with companies that have government business? Has that been going up or down in terms of reviews, number of reviews? Do you know?

MR. HUNTER: Well, over the time period we looked at, you know, it’s not an overwhelming change, the shift in the landscape.

Q: OK. OK.

MR. HUNTER: Some of that may be – may be a hidden signal, if you will, because the financial crisis dramatically reduced the amount of transactions, you know, everywhere in the economy, globally. And so that may be suppressing, you know, a signal that is – that is an increasing trend. You know, but we – I think we suspected, maybe, that we would find a larger increase or a more clear trendline in the number of transactions than we did. But I think it’s not – it would not be, you know, crazy to speculate that the number of transactions is going to sharply increase, but we don’t have the evidence for that yet.
MR. SCHAUS: Most participants, both current and former, would say that CFIUS transaction reviews tend to track closely the overall mergers and acquisitions market. So it’s obviously not a one-to-one, but you know – you know, one-hundredth-to-one or something like that.

Q: Thank you.

Q: Hi. (Name inaudible) – from the AFP News Agency.

You focused on the two rejections, or now three, is it, by presidential, but not on the withdrawn and the makeup of the withdrawn cases, or withdrawn during investigation and withdrawn not refiled. First, are those two different things, or is one a component of the others, the withdrawn and not refiled or withdrawn during investigation?

MR. SCHAUS (?): Sure.

Q: On that one, and then I’d follow up. Just to clarify that issue.

MR. SCHAUS: OK. So the reporting on CFIUS cases is actually very scant. The information provided in the annual reports doesn’t go into great detail about the firms involved. So the best you could do would be to individually analyze press releases by all the companies who did mergers and acquisitions to see if any of them referenced CFIUS, because the committee itself doesn’t release which firms or which sectors were involved in withdrawn cases or refiled cases. So that’s part one.

Part two, I think, of your question was withdrawn and refiled. So, if I understand correctly, of all the withdrawn cases, a subset of those are refiled.

Q: All right. So anyway, I was going to follow up and say that that’s a larger – much larger group of companies than the ones that went to presidential review. Do you have any – can you give us an idea of what those were about? And at what stage are they withdrawn? Are they withdrawn when CFIUS says, you know, we can’t find any mitigation measures? I mean, if you look at the filings from Aixtron, they came up to a point at the end of November where they said, you know, we’re going to go to the president even though CFIUS has made it clear that they’re against us. Has that happened in a lot of these cases, or do they – are they withdrawn a lot earlier? Basically, it seems they’re getting a signal that – can we assume that they’ve gotten a signal they’re rejected? And then, can you give us a picture of who are these companies? Understanding what you said, that there’s not a – there’s not a detailed list out there.

MR. HUNTER: Yeah, I mean, I would – let me just talk generally about, you know, why a company might decide to withdraw. And one thing that came through very strongly in our working group discussion is a lot of these M&A transactions are extremely time sensitive, you know. So they’re all, you know, structured around – all the payment, the discussion of price, is all structured around an assumption of how the assets are worth at a given point in time. And as that point in time might possibly migrate, right, if the deal is expected to close on January 1st, and instead they find that even a one-month or a two-month delay, you know, the market is such that, you know, OK, now stock prices can move quite a bit during that period of time.

And so all of the financial underpinnings of the transaction are very time-sensitive. And so, you know, it might seem ridiculous to say that, well, a 30-day delay in a transaction could be a deal killer, but it really can. It’s one of the things we heard from our working group, because the two stock prices
can – you know, can migrate significantly far away from the original deal that it’s no longer a transaction both sides are interested in carrying out.

So that is a fairly long prelude to say that a company may choose to withdraw not necessarily because the CFIUS process is likely to say no, but simply because, during the course of the review process, the transaction just becomes something that people aren’t feeling, you know, really excited to do anymore. I’m not saying that’s the majority of the cases, but you can’t necessarily conclude that the transaction was withdrawn is because it was the government review that made that happen. It could just be the timeline, or the deal might have fallen apart even if the government wasn’t reviewing it.

So, having said that, certainly there are cases where things are withdrawn because people get into the CFIUS process and say, oh, boy, we didn’t think about that. You know, we didn’t think about the fact that this subsidiary, which is maybe – I mean, just speaking notionally, you know, 30 percent of the value of the deal is something the U.S. government is never going to allow to go to a foreign company.

Well, gosh, you know, there’s no way to mitigate it. We’re not interested in buying the company if that piece of the company is spun off. So the deal may become nonviable. And both sides may recognize, say, yeah, this is just not going to work. And so the logical thing for the company to do is to withdraw. They may or may not refile. You know, so there’s a whole range of possible scenarios that would lead someone to withdraw. And it may be that the government has said no, or it may be that, you know, when both sides really dig into what the national-security concerns are, the transaction just doesn’t make sense.

Q: One more, if I can follow up on that. In the case of mitigation measures, when you have numbers down there, are those deals that went through after they implemented mitigation measures? Or are those where CFIUS recommended mitigation measures but we don’t know what happened; we don’t know if the deal went through? Is there –

MR. HUNTER: The first.

Q: OK.

MR. SCHHAUS: If I can add just a little bit to Andrew and some flavor of the working-group discussions on the when and why cases are withdrawn, we don’t have any information to speak to sectors or anything like that. We just – I mean, we looked. We couldn’t –

Q: All countries.

MR. SCHHAUS: Yeah. We weren’t able to find that. But another piece is that, particularly in the early kind of 2008-2009-2010-2011 years, there was a stigma attached culturally to cases going into investigation. And so often what would happen is as parties were coming close to the 30-day – they’d come to the first review period – if they felt like we’re getting close but we can’t actually resolve it in this period, they would withdraw, refile with a slightly restructured format, and then conclude the deal very quickly in that new filing period, because they wanted to avoid going into investigation. So I think that stigma is falling. You’re seeing the number of cases going to investigation increasing, because I think people are – parties are more willing to engage in that step of the process.

MR. QUINN: Let’s let Tony –

The chief of the Defense Security Service has likened the situation now for American defense companies – says you’re in a knife fight and you don’t know it. That’s what he said. He said foreign intelligence services are using the globalization of business to get inside our supply chains and steal our secrets, steal our technology.

During your research putting this together, what type of concerns did you hear about that? And if you went over this earlier, I again apologize I’m late. But that’s a pretty strong statement from the guy in charge of securing the supply chain.

MR. HUNTER: Yeah. A couple of thoughts on that. And maybe I should scroll them down so I don’t, in the middle, forget what I was going to say. (Laughs.)

OK. One of the things that John mentioned that is really important and merits mentioning again, to emphasize it, is CFIUS is only one of many government mechanisms to protect the industrial base. And, in fact, formally speaking, it is meant to sort of be the last – you know, the last measure. So when everything else is unable to address a problem, then the president gets involved under the statute with CFIUS and tries to make sure that national security is protected as a last measure.

So CFIUS is the last mechanism, and it’s one of only several mechanisms. It’s also one of only several mechanisms – foreign investment in U.S. companies is one of only several mechanisms by which people who are trying to get information out of U.S. industry seek to do that. And so, you know, of course, cyber is another big issue that people can, without ever seeking to invest in a company, perhaps go after parts of the supply chain for information.

One of the things that came up in the working-group discussion that is again very – well, that is, by its nature, impossible to measure is that when a company – you know, when a company does indicate that it’s perhaps willing to be acquired, you know, what you will see is a lot of potential investors will come and, you know, they’ll usually kind of put together a prospectus – and that’s probably not the right word, but a body of information for potential acquirers to review.

And, you know, there was some discussion about the fact that, you know, you can just sort of window-shop. You can find out a lot of information about U.S. industry by reviewing information about companies that are interested potentially in being acquired. You don’t even have to acquire them. There’s quite a bit of information that can be attained.

And that’s the nature of the U.S. economy, right, that it’s pretty open. There’s a lot of publicly available data about U.S. companies. And then companies that are in the process perhaps of making themselves available to be acquired put an even greater variety and depth and detail of information about their operations out there for potential investors to review.

So there’s definitely a lot going on out there, and CFIUS is only one, probably, I think arguably, relatively small piece of the puzzle in terms of measures to protect U.S. industry. But because it does involve the government saying we’re going to tell you what you can and cannot do, and it’s the president who’s doing it, it is, in some ways, the strongest mechanism.
Q: Allow me one quick follow then. So in case you did go over it and I did miss it, could you help me connect the dots then between the trend lines we see now with – we have an incoming presidential administration that embraces the sort of new tide of populism. I don’t know how excited the administration is going to be at the prospect of outside entities purchasing American companies or any companies that are involved in defense.

What should defense contractors understand about this process and the new administration and how – you know, what do you think the interplay will be?

MR. HUNTER: Yeah, I mean, it’s really – it’s really too early to tell. And let me kind of circle back to this concept of FOCI – foreign ownership, control and interest. You know, I mean, when you look at – and I’m not by any means an expert on the Trump organization, but it’s a highly international organization and it has a lot of international investment partners. So, you know, one looks at that and says, OK, this is not someone who feels like international investment is a bad thing. Some large percentage of all his business deals involve some degree of international investment.

So one would assume that it would be – you know, it would be something that he would understand that international investment doesn’t de facto mean that one is compromised. That would seem to follow.

So it’s a little hard to say. If one just looks at it in the idealized world, you could say, OK, well, foreign investment is investment here. And that’s jobs here. So, you know, if the jobs are here, the money’s coming from overseas, from a – one possible way of looking at the world, you say, hey, you know, where’s the down side, OK? We’re getting money from other countries to come here, to employ people here. You know, that could be a real positive. Well, of course, there are potential national-security concerns. That’s why we have CFIUS. So, you know, I’m not saying it’s all – it’s going to be something that the Trump administration is going to embrace whole hog, but I don’t necessarily see that it’s obvious that it’s going to be something that we’re going to oppose; foreign investment would be something that they would oppose.

A lot will – you know, what I mentioned, I think, Tony, before you came in, is I think when Secretary – well, he’s not secretary yet – when the presumed nominee for secretary of treasury goes through confirmation, my expectation is that CFIUS is going to be something that he’s asked about. And we’ll get an early – hopefully an early signal of their perspective on the CFIUS process through the confirmation process.

Q: Yeah, Eric Kulisch with American Shipper Magazine again.

Just kind of piggybacking on that, so yesterday President-elect Trump touted an investment by a major Japanese bank, along with, I think, has part of the investments from Saudi Arabia as well. I didn’t read a whole lot of details on it. So I’m not even sure exactly the parameters of that investment and whether it would even come up for CFIUS review. But that’s an example of foreign investment that he seemed to be in favor of.

MR. HUNTER: Exactly, yeah.

Q: So I don’t know if you want to comment on whether it’s CFIUS-eligible.
But then, along those lines – and you may have already kind of addressed this – do you see the Trump administration or Congress trying to redefine national security in more, you know, broader terms of economic security too so it has a wider, you know, basket to catch some of these things?

MR. HUNTER: OK, I just want to make sure I get both halves of your question.

So, like you, I’m not intimately familiar with what’s being proposed. What I have heard or read is that, with the SoftBank investment, is that it’s a – that he’s talked about $50 billion of an overall $100 billion investment fund potentially being targeted for investments in the United States. So, yeah, I think that would absolutely give rise to CFIUS reviews, almost certainly. You’re talking about $50 billion. It’s hard to imagine, assuming that’s not all one transaction – it’s a series of transactions – I think almost inevitably, you know, there will be some CFIUS review involved. I mean, that’s speculative, but when you’re talking about that much money, I think you’re going to end up with some companies that have some national-security element to them.

You know, I guess we’ll wait and see. But it’s exactly a case in point of the president-elect welcoming substantial foreign investment into the U.S., because he saw it, at least as he articulated it – I think it was yesterday – as a way of generating jobs here in the United States.

On the issue of national security, I mean, we have seen members of Congress pushing to expand the scope of CFIUS. I think Senator Schumer was in that camp. And, of course, he’s now an even more influential member of Congress on these issues because he’ll be the top Democrat in the Senate, and, of course, being a senator from New York, is pretty tied in through his constituency with mergers-and acquisitions activity. So I think he is a definite influence on these issues.

So you do see that. You do see some desire in Congress to expand the definition of national security. You know, we’ve kind of – we didn’t, I think, look so carefully at that definition in our working-group process, but we did look at some issues of the definitions that are in the statute. One of the things we focused on specifically was the threshold that the CFIUS process is designed to establish. And I’m probably going to mangle this, so I’m going to look at John. But basically the government is supposed to take action until there is – what is the word? Is it no risk or –

MR. SCHAUS: No unresolved –

MR. HUNTER: No unresolved risk to U.S. national security as a result of the transaction. And it’s a kind of – you know, in some ways, if you look at it, it could be read exceptionally conservatively. No unresolved risk is kind of the same as saying no risk. And we don’t live in a world where you ever get to a point of no risk. And so, you know, it hasn’t been interpreted that conservatively. I think the government has been flexible and has not sort of taken a we can’t tolerate any risk at all in transactions. They’ve been more reasonable than that.

But the language of the statute is fairly stark. And so we did look a little bit at the question of could the standard be modified to be more perhaps reflective of the way that the policy has actually been implemented. And what we ultimately decided is there’s not an easy way to do that. It might do more harm than good, because essentially you’d be taking it to Congress and say, hey, we want a weaker standard for reviews of foreign investments. That’s unlikely to generate a change in statute that everyone agreed would be helpful. So, in fact, we’ve got pretty strong (sides ?) that will say that’s a terrible idea. So we didn’t do that.
But I think your point is well taken that the way that these things are defined can have a huge influence on the way the process works. But we didn’t look specifically at changing the definition of national security. We didn’t hear from our working group that there were big issues in the way national security is defined.

Q: Can I quickly ask – you know, the – China and the U.S. are negotiating this Bilateral Investment Treaty. The Chinese hope that this will help sort of the – changing how the Chinese FDI is treated in the U.S. So where does BIT, you know, change in how Chinese FDI are being screened by CFIUS, you know?

I just want to make a quick comment. You just said earlier about the AMC case. You said a military base has AMC theaters, so it makes it a national security concern. So obviously Chinese cannot buy Starbucks now; Pentagon has four Starbucks inside the building. But you know, the Chinese could have made a same argument if they denied GE, you know, or this Boeing business in China because they all have a close relationship with the Pentagon, you know, with the government. That’s, you know, military-industrial complex. So I don’t know if that would stand, that kind of argument, you know.

MR. HUNTER: Yeah, you know, the deal went through.

MR. SCHAUS: Right.

MR. HUNTER: So, I mean, it’s not saying you can’t do it if – because there’s a fear of a military base. It’s just saying that – and again, the company decision to voluntary file gave them safe harbor that no one could come back later and say, wait a minute, you just bought a company that has facilities on U.S. military bases and you didn’t go to the national security review.

So, you know, I would argue, I guess, from the other direction and say this was a case where the company decided there was some risk, they wanted that risk to be mitigated in order for the transaction – you know, to make sure the transaction isn’t overturned later. And so they went through the review, and they got the green light.

So, you know, I see that as a case of the process working and a – essentially then foreign investment being welcomed from China in that case.

Q: BIT?

MR. SCHAUS: So I think that the slide I put up with the five largest investors, Canada – NAFTA is about the most open free trade agreement that the United States is part of, and yet Canada is one of the most scrutinized, not in terms of depth of scrutiny but in terms of frequency, of any country.

So I think – I don’t think that a free trade agreement is a free pass for any country in, you know, national security speak.

MR. HUNTER: Yeah. I mean, and this may sound a little perverse, but in some ways, having more CFIUS reviews indicates that you’re almost a closer industrial partner of the United States. You know, what you see is, you know, the countries up there are our closest allies and partners by and large.

Q: Jack Caporal with Inside U.S. Trade.
I’m just wondering if the issue or the idea of requiring CFIUS review for any merger or acquisition proposed by a Chinese state-owned enterprise was discussed in the working groups. It’s something that’s been recommended by the U.S.-China Economic and Security Review Commission for a number of years. And I also believe the GAO in its review of CFIUS that it recently announced will look into that recommendation as well.

So just wondering if there’s any way to gauge the temperature on that idea.

MR. HUNTER: Yeah, and so we did talk about – and that’s an element. It’s – of moving away from a voluntary filing approach. And the participants in the process, both private sector and government, basically agreed that that would likely be a bad idea. And the reason is, as we mentioned on the resourcing side, you know, this system as it works today could be quickly overwhelmed if they had to, you know, double, triple, quadruple the number of reviews that they were engaged in. The quality of the reviews would go down very quickly. The timeline – you know, it would really make the system be less effective than it is today.

So I guess the case would be you need a pretty, I think, high level of evidence that shows that the foreign investment mechanism is leading to major U.S. national security losses, to say we’re going to review every transaction from a given country, because the likelihood is that you’re then going to be reviewing – you know, out of every 25 cases reviewed, you know, one of them is going to have real national security issues and you’re going churn and waste resources on the other 24 going through the initial 45-day – or is it – is the initial 30 and –

MR. SCHAUS: Thirty and then 45.

MR. HUNTER: – 30-day review. So, you know, that – I – you know, off the cuff, that was discussed in our working group discussions. I didn’t recall there being anyone who thought that that was the right approach, to move away from the voluntary. You know, the government does have the opportunity to request people to file or to make people file when it – when it sees any. And that’s a – that is a risk-based assessment, you know, based on intelligence and where there would be a reason to compel a company to file.

So the discussions that we had suggested that that approach is the right balance.

MR. QUINN: Folks, I think we’re coming up against time here. If there’s any final questions – we’re probably – probably clear on that. OK.

Well, thank you guys so much for coming. I certainly learned something today and, you know, learn something every day working here. So thank you to Andrew and thank you to John for giving up their team. And thank you, guys, for coming.

As I mentioned at the start, we will be sending out transcripts later today. If for some reason you maybe weren’t on the list or you want to get on the list – if you haven’t received our invite, that’s a good indication that you may not have been. Just letting you know. We’ll make sure to put you on.

OK, thank you very much. Thank you.

(END)