As part of our ongoing coverage at the intersection of national security and foreign investment, we regularly speak to experts for their insights and perspective on a variety of topics. This week, we sit down (virtually, of course) with Doreen Edelman, Partner and Chair of the Global Trade and Policy practice at Lowenstein Sandler. Doreen has deep knowledge of CFIUS and the new requirements under FIRRMA, and advises companies on the Bureau of Industry and Security and the Directorate of Defense Controls export control regulations. She was also featured in the Foreign Investment Watch “Top Advisors 2020” list this year.

Doreen, first things first: How have you and your family been faring during the pandemic?

My son and daughter-in-law both had the virus in February and are labeled by their state as patients numbers 10 and 11. They were both very sick. Now they are giving plasma every three weeks and helping to save lives. I think it is good to share positive events as all the news swirling around us trends negative!

That’s unbelievable; I’m glad they’re doing better. Let’s jump in, and talk about the global investment market. Recent data seem to indicate that – between the pandemic and CFIUS – foreign investment in the U.S. has fallen off a cliff. Have you seen activity drying up?

There is definitely a decline. In fact, the Bureau of Economic Analysis released its yearly report on July 1, and noted that FDI (foreign direct investment) is actually down from an all-time high in 2015. We did see a large decline in 2019, and I am sure 2020 will show an even larger drop. The cause I believe is fourfold:

1. The U.S. government’s focus on foreign investment with the changes to CFIUS;
2. The health pandemic;
3. The unilateral and unpredictable U.S. tariffs on foreign products;

4. The impression that the U.S. is no longer the most transparent and predictable place to invest.

**Are those in any particular order?**

Well, the pandemic would be first, and foreign investment regime second. Tariffs probably last.

**Can we talk about general awareness of CFIUS in the investment market?** From our conversations, it appears that a lot of investors – and certainly startups – are relatively oblivious when it comes to CFIUS and other national regulatory regimes. Is that your experience?

Wow. Big question. I can only tell you what I am seeing. I see two different sides. Yes, I totally agree that startups and many PE and venture fund companies are not aware of CFIUS at all. And some that are aware are reacting to the hype and not the actual facts. CFIUS has not stopped most transactions from the top countries investing in the U.S. There is a lot of misinformation out there. The key point is that the odds are CFIUS will not alter a transaction, but it should be one of the first items on your pre-deal checklist. This is important because how the deal is structured can ensure that CFIUS review is not a serious concern. You must undertake a CFIUS analysis.

This leads me to my second point: Some foreign entities are structuring to avoid CFIUS or will proceed without obtaining a safe harbor and baking the risk into the deal. These companies are well aware of the law. Good CFIUS counsel is key to protect each party’s interests and future liability since CFIUS is now actively looking at deals from the past, particularly those with Chinese beneficial owners in an investment structure.

**What about activity related to the real estate provisions of FIRRMA?** We’ve written a lot about the rule but have only seen one relevant case: an offshore sale of 78 million acres in federal waters off the Gulf of Mexico, which the Bureau of Ocean Energy Management said could be impacted by the FIRRMA real estate provisions. What are you seeing in the real estate market?

The real estate provisions are relatively new. The regulations were effective as of Feb. 13 and now cover not just investment in a U.S. business with real estate but also leases, purchased land, and concessions on their own merit without the purchase of an ongoing business. But the reviews are limited to property near sensitive U.S. locations like airports, maritime ports, and military installations. Even then there are more limits, like a location must be within the facility or be within a mile of the military installation or 100 miles of certain training centers or ranges. Then there are all of the exclusions. These relate to urban centers, houses, and retail purposes that offer exclusion from jurisdiction. And just because the property is a covered real estate transaction doesn’t mean a filing is required. In fact, covered real estate transactions are voluntary filings. Thus, my point is yes, the issue needs to be considered, and in 99% of the cases, the requirements will likely not necessitate a filing. But know that CFIUS has staff to review real estate transactions and is concerned about real estate investments near sensitive facilities.

That’s fantastic insight, thanks. Much has been written about CFIUS, but not much has been written about the Trusted Capital Program and how it can serve as a complement to CFIUS. Can you explain what the Trusted Capital Program is?
The Trusted Capital Program is a DOD [Department of Defense] program that seeks to preempt CFIUS concerns for companies by creating a program to match prescreened investors with companies working on technology or products of national security interest. The DOD aims to provide a secure ecosystem of capital to support investment in U.S. companies, and it will also provide diligence on the investors and companies and government thinking on the direction of U.S. national security priorities. Many other countries already have such programs, so let’s hope this will gain traction.

I know you’ve written about a little-known requirement from the Bureau of Economic Analysis that mandates the reporting of all foreign direct investments. Give us an overview of that requirement.

You are referring to the reporting obligations under the International Investment and Trade in Services Survey Act. The act, which is not new, includes mandatory reporting requirements that oblige all U.S. businesses to file reports identifying FDI that results in a foreign entity owning or controlling 10% or more of the U.S. business. Reports are filed at the inception of the investment and then every five years in a follow-up “benchmark survey.” The BEA may also contact a company to make additional filings.

The number of filings and the specific report depends on the dollar value of the investment and the business structure. In fact, even if the business is exempt based on the dollar value of the investment, an exemption form must be filed. Reports go to the BEA at the Department of Commerce, and that is why they are referred to as the BEA filings. There are four types of forms that may apply: the FDI Survey (Form BE-13), the Quarterly Survey (Form BE-605), the Annual Survey (Form BE-15), and the five-year Benchmark Survey (Form BE-12).

Several companies have asked us about common pitfalls or traps that have tripped up others with CFIUS. Do you have any insights for them?

That is difficult because there are so many variables in a transaction.

1. There is real risk if you do not know the export classification of the U.S. technology. You can’t “wing it” on this issue.

2. You need to know all the foreign ownership going all the way back to the beneficial owners. We have seen companies investing in U.S. entities and the U.S. entities did not know that they already had foreign ownership up the chain.

3. Then there is your risk tolerance. Can the parties handle the future risk if they don’t make a voluntary filing and [maybe a year or two later later] CFIUS determines that there are national security risks and the buyer must divest.

4. I think the most important point is an entity needs to start thinking about CFIUS when the term sheet is being developed. It is never too early. In fact, if you know deal risks early, you can structure the transaction to minimize risk by keeping the foreign investors segregated from the company.

5. And finally – China. Any transaction that has Chinese investment is by definition subject to attention by CFIUS. You will see more transactions reviewed [after the] deal execution and more transactions actually proposing mitigation options as part of the transaction itself.

Thanks Doreen.
Doreen can be reached at DEdelman@lowenstein.com or 202.753.3808.