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Expert Q&A on the Role of CFIUS in Bankruptcy Transactions

Foreign investment transactions arising from bankruptcy proceedings are likely to face more scrutiny due to the expanded role of the Committee on Foreign Investment in the United States (CFIUS) in reviewing transactions for potential national security risks under the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA). Practical Law asked *Shana A. Elberg* and *Michael E. Leiter* of *Skadden, Arps, Slate, Meagher & Flom LLP* to explain CFIUS' role in bankruptcy proceedings and provide practical tips for restructuring professionals on the intersection between FIRRMA and bankruptcy.



SHANA A. ELBERG

PARTNER
SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP

Shana's practice focuses on business reorganizations and cross-border, insolvency, and bankruptcy matters. She has substantial experience advising companies, creditors, equity holders, lenders, investors, sellers, purchasers, and other parties-in-interest in a variety of distressed situations and restructuring transactions, including prepackaged and prearranged bankruptcies, traditional Chapter 11 cases, and out-of-court workouts and acquisitions.



MICHAEL E. LEITER

PARTNER
SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP

Michael's practice focuses on US national security and cybersecurity matters, cross-border transactions, and government investigations, particularly in the defense, intelligence, and technology sectors. He has represented numerous clients in reviews before CFIUS. Previously Michael held senior national security positions in the federal government and was responsible for oversight of the CFIUS process.

How did the enactment of FIRRMA expand CFIUS' jurisdiction over bankruptcy transactions?

Congress updated the laws governing CFIUS for the first time in over a decade by passing FIRRMA, which increased CFIUS' jurisdiction, authority, and resources. Interim regulations implementing parts of the legislation were adopted in late 2018 to include a pilot program that requires mandatory filing of declarations with CFIUS in a narrow set of transactions. Final regulations, due to be issued by early 2020, are expected to clarify the increased scope of CFIUS' jurisdiction and provide more specific guidance with respect to bankruptcy proceedings.

While FIRRMA generally expanded CFIUS' jurisdiction, the law has not significantly changed CFIUS practice regarding bankruptcy. CFIUS has always reviewed acquisitions that fall under the definition of a "covered transaction" arising from bankruptcy proceedings. FIRRMA simply empowers CFIUS to take a more active role in bankruptcy cases, which have been identified as an avenue for foreign investors to bypass CFIUS review. Specifically, FIRRMA:

- Codifies pre-existing practice by requiring that CFIUS prescribe regulations clarifying that a covered transaction includes any transaction arising from bankruptcy proceedings that would otherwise fall under its jurisdiction.
- Significantly expands the definition of a covered transaction.
- Provides CFIUS more resources, allowing it to proactively scrutinize transactions that were not voluntarily filed with CFIUS for review.

Companies should be aware that their bankruptcy transactions could fall within the realm of covered transactions, or may be subject to mandatory filing requirements.

Covered Transactions

Prior to the passage of FIRRMA, covered transactions were generally defined as transactions that could result in foreign control of a US business. CFIUS viewed any acquisition of greater than 10% equity, or in some cases 10% equity or less with board representation or other direct or indirect governance rights, as "control." FIRRMA's definition, however, expands CFIUS' jurisdiction to include:

- Non-controlling transactions, particularly those involving non-passive investment by a foreign person in US businesses involved in:
 - critical infrastructure;
 - producing critical technologies; or
 - maintaining sensitive personal data that, if exploited, could threaten national security.
- Foreign acquisitions of real estate in sensitive locations.

This expansion of CFIUS' jurisdiction increases the likelihood that bankruptcy transactions will be covered transactions and that CFIUS will review those transactions.

Mandatory Filings

Under FIRRMA, parties will be subject to mandatory filings for certain transactions. Once final regulations are issued for FIRRMA, parties will have to file a declaration if a foreign government has a substantial interest in the acquiring foreign person, and the transaction relates to an investment in a US business involved in critical technology, critical infrastructure, or the personal data of US citizens. "Substantial interest" has yet to be defined by regulations, but the legislation requires CFIUS to consider means by which a foreign government could influence the actions of a foreign person, including through board membership, an ownership interest, or shareholder rights.

CFIUS is also authorized by FIRRMA to expand mandatory filings to other investments in critical technology companies. A pilot program implemented through interim regulations introduces FIRRMA's mandatory filings for these investments. If a covered transaction involves critical technology companies operating in any of 27 identified industries, parties will have to file a declaration containing details about the transaction at least 45 days prior to closing. Companies may also be covered even if they are not operating in one of the 27 industries if they are operating for the specific support of an identified industry. Previously, CFIUS filings were voluntary, but currently failure to file a mandatory declaration may mean both parties could be liable for a substantial financial penalty. This would also apply to covered transactions arising from bankruptcy proceedings.

Under the FIRRMA pilot program, parties are subject to mandatory filing with CFIUS if they take part in a pilot program covered transaction. Notably, as authorized by FIRRMA, CFIUS did not limit the scope of this requirement to transactions involving foreign-government-controlled parties. This may reflect the inherent difficulty of requiring parties to determine for themselves whether a foreign investor would qualify as a foreign-government-controlled investor for CFIUS purposes.

Pilot program parties must file a short-form declaration or full notice for any pilot program covered transaction at least 45 days before the transaction close date. After accepting the declaration, CFIUS has 30 days to respond by taking one of the following steps:

- Clearing the transaction.
- Requesting a full notice.
- Initiating a unilateral review.

Parties may benefit from filing a full notice as opposed to a declaration in the first instance, especially when engaged in a complex or higher risk transaction that is likely to take CFIUS more than 30 days to clear. It is vital that the debtor and buyer determine whether they are subject to mandatory declarations under the pilot program, because failure to file can expose both parties to the transaction to a civil penalty up to the value of the transaction. This could be particularly costly during a bankruptcy proceeding. CFIUS has not yet issued guidance on the allocation of the penalties between the parties.

FIRRMMA provided CFIUS the resources and mandate to review transactions (including concluded transactions) even if they have not been voluntarily filed. Bankruptcy proceedings may be particularly attractive for CFIUS review, given the relative ease of obtaining background documentation from the bankruptcy docket, and because significant bankruptcy proceedings often receive media coverage. While debtor companies may wish to maximize value from the sale of distressed assets, they must consider not only the purchase price offered, but also the risks of selling to certain foreign buyers. Sellers contemplating a transaction that involves a foreign buyer should consider:

- How the possibility of an extended timeline for completing a transaction may materially affect the value of the transaction.
- Whether a transaction will obtain CFIUS clearance at all.
- How failure to obtain CFIUS clearance will affect a transaction.



Search [FIRRMMA Signed into Law, Expanding Scope of CFIUS Review and US Treasury Department Issues Interim Regulations for FIRRMMA Pilot Program](#) for more on FIRRMMA and the interim regulations.

What is the scope of transactions in a bankruptcy case that may be subject to CFIUS review?

A transaction arising from a bankruptcy case may be subject to CFIUS review if that transaction meets the definition of a covered transaction. Before the enactment of FIRRMMA, this generally included any merger, acquisition, or takeover that could result in foreign control of a US business. The new, expanded definition includes the purchase or lease of some types of sensitive real estate, and certain non-controlling transactions.

If a bankruptcy transaction falls under the new definition of a covered transaction it may be subject to CFIUS review, meaning that foreign buyers of US distressed assets will be more likely to find their proposed acquisition scrutinized. Debtor companies and foreign buyers (including creditors receiving equity in exchange for debt) should cautiously review the assets being acquired to identify if the assets trigger CFIUS' jurisdiction, and to confirm that they do not, inadvertently, acquire covered assets without addressing the risk of a CFIUS action.

Real Estate

FIRRMMA codifies the existing CFIUS practice of scrutinizing real estate transactions that are sensitive for national security reasons. Previously, CFIUS would analyze the real estate involved in a covered transaction (that is, a foreign acquisition of a US business), but could not independently review the acquisition of real estate alone as a covered transaction. FIRRMMA expands CFIUS' jurisdiction to review acquisitions of real estate. For example, real estate might make an acquisition a covered transaction for one of the following reasons:

- Its location within an air or sea port.
- Its proximity to sensitive US government property, such as military bases.
- Its suitability to collect intelligence or surveil sensitive US government property.

FIRRMMA provides an exception for single housing units and for real estate in urbanized areas. A bankruptcy proceeding involving a real estate acquisition by a foreign person might therefore be subject to CFIUS review (even if there is otherwise no acquisition of a US business), and sellers should consider how CFIUS will analyze any potential risks.

Non-Controlling Investments

FIRRMMA defines "other investments" broadly. Generally, these non-controlling transactions include any direct or indirect investments that would otherwise not fall under the definition of a covered transaction, but which give a foreign investor some control or access to a US business where there is a potential national security risk. Specifically, CFIUS has jurisdiction if a foreign investor gains decision-making rights through investments in a US business involving any of the following:

- Critical infrastructure.
- Critical technologies.
- Maintenance or collection of sensitive personal data that, if exploited, could pose a threat to national security.



Search [Expert Q&A on the Role of CFIUS in Bankruptcy Transactions](#) for the complete online version of this resource, including detailed definitions of FIRRMMA terms.

Contingent Equity Interests

The interim regulations address "contingent equity" as a form of investment. In practice, the previous regulations only considered contingent equity interests once exercised, but FIRRMMA treats these investments as covered when the securities are first acquired. Based on the treatment of convertible securities in the context of the pilot program regulations, the final regulations will likely clarify when the issuance of convertible securities will trigger CFIUS' jurisdiction. In a bankruptcy case, a debt-to-equity conversion might trigger CFIUS' jurisdiction, but not as conditional equity because the conversion was probably not contemplated at the time the loan was made.

What types of sensitive personal data in a bankruptcy case could give rise to CFIUS review?

Regulations have not yet been issued to further define "sensitive personal data." CFIUS has, however, previously scrutinized transactions in which a foreign party could gain access to personal information of US citizens. Generally, FIRRMMA codifies existing CFIUS practice or expands CFIUS' jurisdiction. Therefore, previous decisions likely are indicative of how CFIUS will interpret the scope of sensitive personal data. CFIUS has taken an extremely broad view of what is sensitive, finding the following types of data as potentially sensitive:

- Geolocation information.
- Consumer financial and payment information.
- Health information.
- Telecommunications and internet usage information.
- Other data which could be exploited to the detriment of national security.

CFIUS will also routinely consider the volume of data involved and how effectively the data can be protected or anonymized. Given that sensitive personal data could be defined broadly, debtor companies should consider bulk data they hold.

This interpretation fits with the stated purpose of FIRRMA, which is to modernize the CFIUS process considering new risks that have arisen since the previous reforms more than a decade ago. FIRRMA's "Sense of Congress" provision raises concerns about the national security risks that may result if foreign governments or persons gain access to personally identifiable information, genetic information, or other sensitive data of US citizens.

FIRRMA also highlights the threat posed by transactions which might exacerbate or create cybersecurity vulnerabilities. This opens the door to a very broad interpretation of what will be considered sensitive personal data. CFIUS will consider risks posed not only by obtaining individual data sets, but also by potentially exploiting that data in combination with other data and personal information. Therefore, many data sets containing personal information likely would be considered an exploitable threat to national security. CFIUS is currently working on clarifying what will, and will not, be personal data subject to CFIUS scrutiny, although achieving significantly greater clarity is unlikely.

What bankruptcy-specific regulations are anticipated under FIRRMA?

No bankruptcy-specific regulations were issued as part of FIRRMA's pilot program. Final regulations implementing all elements of FIRRMA must be issued by February 2020. CFIUS will be required to issue regulations clarifying that the term covered transaction includes any transaction described under FIRRMA's new definition that arises pursuant to a bankruptcy proceeding or other form of default on debt.

This clarification will ensure transactions arising from bankruptcy proceedings are not deemed exempt from CFIUS' purview. However, beyond this, bankruptcy transactions will likely be treated as any other covered transaction. The fact that a specific transaction arises from a bankruptcy, as opposed to any other merger, acquisition, or takeover, is irrelevant. What remains relevant is whether a foreign person is either:

- Taking control of a US business.
- Acquiring covered real estate with a national security interest.
- Investing in a business related to:
 - critical infrastructure;
 - critical technologies; or
 - an opportunity to exploit sensitive personal data.

Has CFIUS appeared in any recent bankruptcy cases?

The US government has filed notices in a few recent Chapter 11 cases, generally stating its intent "to address the possibility that certain transactions contemplated [by a plan or sale] may be subject to review by [CFIUS], which could affect the ability of the parties to complete the transactions, the timing of their completion, and/or their terms." The notices do not address

the specific applicability of CFIUS review to any proposed transaction, but rather state:

- CFIUS' purpose and membership.
- The CFIUS review process.
- The confidentiality of the CFIUS review process.

Even before the enactment of FIRRMA, parties to section 363 sales sought CFIUS review before consummating a sale transaction.



Search [Expert Q&A on the Role of CFIUS in Bankruptcy Transactions](#) for the complete online version of this resource, including citations to example cases.

There is currently no public database of CFIUS filings and outcomes, and outcomes of CFIUS review are not public information (unless the parties choose to release the outcomes or, in extremely unlikely circumstances, the CFIUS process results in a decision by the president). To date, no presidential decision on a CFIUS review has been required in a bankruptcy transaction.

Although CFIUS has reviewed bankruptcy-related transactions in the past, we expect more transactions arising from bankruptcy proceedings to be filed with CFIUS, reflecting FIRRMA's expansion of CFIUS' jurisdiction and resources generally, as well as heightened attention based on FIRRMA's explicit reference to bankruptcy-related transactions.

What steps can a debtor company take to prepare for a potential CFIUS review?

Proper due diligence on US operations relating to a bankruptcy transaction involving a foreign buyer is critical. It is vital to identify any part of a US business, or other entities and assets, being sold that could fall under CFIUS' jurisdiction. Even a comparatively minor element of a transaction, including one that may be deemed financially immaterial, could result in deal risk or delay if it is deemed to pose a risk to US national security when acquired by a foreign buyer. Initial issues a debtor company should consider related to its own assets include:

- What likely national security vulnerabilities CFIUS could identify.
- Whether there is a way to mitigate risks to national security associated with the business (for example, by removing sensitive assets from a proposed deal).

The debtor company should also identify whether a foreign buyer is likely to be viewed as a potential risk by CFIUS. Many recent CFIUS cases have involved Chinese buyers, but any foreign buyer of US businesses should be reviewed to identify if further scrutiny by CFIUS may be warranted. Initial issues the debtor company should consider include whether:

- The buyer is a foreign person, or in part owned or controlled by foreign persons.
- The foreign person is from a country of particular national security concern.
- A foreign government has a substantial interest in the foreign buyer.

Timing

Though it can be difficult to identify the ownership chain of a potential buyer, especially when operating under time pressure during a bankruptcy, it is extremely important that debtor companies attempt to do so. An unidentified CFIUS risk may result in a filing that can significantly delay the closing process during a bankruptcy proceeding, which often depends on court-ordered or financially driven timelines.

Further, CFIUS can review transactions even after they have closed. If a national security problem comes to light late in the transaction or after it has concluded, CFIUS can still review and prohibit the transaction. In addition to financial risks to the buyer, this could also result in negative media attention on the debtor.

Mitigation

CFIUS attempts to mitigate risks to national security through modifications to the deal or other controls. A debtor company preparing for a potential CFIUS review should therefore identify possible mitigation options. For example, a seller might:

- Place sensitive assets in a US controlled trust.
- Keep US citizens on the board of a key department.
- Remove sensitive assets from the deal entirely, if possible.

How is the CFIUS review process triggered for bankruptcy transactions and how long can it take?

Generally, the CFIUS process begins when the parties to a proposed transaction jointly file a declaration or voluntary notice. Depending on the specific circumstances of the transaction, the process can take four to six months to complete.

A voluntary notice contains each of the following:

- A description of the transaction.
- The background of the parties involved.
- Information regarding the parties' business activities.

If the notice is complete, the CFIUS staff chairperson circulates the notice to all CFIUS members, and a review period of up to 45 days begins on the next business day. If the notice is incomplete it can take an additional month or longer under current regulations.

During the review period, CFIUS members examine the transaction to identify and address, as appropriate, any national security concerns that arise because of the transaction. CFIUS may also request additional information from the parties, and may initiate an investigation after the review period, which must be completed within 45 days. After the investigation period, CFIUS can take one of the following actions:

- Clear the transaction.
- Require that the parties agree to measures to mitigate the transaction.
- Refer the transaction to the president for decision, in which case the president has 15 days to announce a decision.

If CFIUS finds that the covered transaction does not present national security risks, then CFIUS will advise the parties in writing that it has concluded all action with respect to the transaction. On the other hand, if CFIUS finds that the covered transaction presents national security risks and that other provisions of law do not provide adequate authority to address the risks, then CFIUS may enter into an agreement with, or impose conditions on, parties to mitigate the risks or may refer the case to the president for action. The president has the power to block, mitigate, or unwind transactions deemed to impair national security.

When CFIUS has completed all action or the president has announced a decision not to exercise his authority with respect to the covered transaction, then the parties receive a "safe harbor" with respect to that transaction. This safe harbor protects the parties from future CFIUS action on the same transaction.



Search [Clearing Foreign Investment in US Businesses Through the Committee on Foreign Investment in the United States](#) for more on the CFIUS review process.

What is the process for challenging a determination by CFIUS?

Historically, judicial review of CFIUS actions has been extremely limited, with only one district court opinion in the past two decades. FIRREA includes provisions for judicial review of CFIUS actions and decisions. Civil actions challenging CFIUS may be brought before the US Court of Appeals for the District of Columbia Circuit, subject to provisions for the handling of classified, privileged, and other sensitive information. However, judicial review of presidential actions and findings resulting from CFIUS cases is prohibited.

In practice, this will severely limit the number of cases litigated because challenging a decision on the merits is difficult without access to classified information. Litigants are more likely to make a constitutional challenge on the grounds of failure to receive due process, or may seek to challenge CFIUS' jurisdiction over a transaction. Even then, the litigation process may be prohibitively lengthy in the context of a pending transaction, especially one undertaken through bankruptcy.