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UK and New Zealand to remain excepted foreign states. Big whoop?

CFIUS has determined that the UK and New Zealand will remain "excepted foreign states." That means that qualifying investors from all "Five Eyes" countries will continue to be excepted from CFIUS review of certain types of transactions.

Here are all the details in outline form:

WHAT HAPPENED

Last week, the U.S. Treasury Department announced that CFIUS would keep the UK and New Zealand as "excepted foreign states." The decision was based on those countries' own "robust foreign investment screening programs."

The continued "EFS" status of those counties means that all Five Eyes counties will continue to benefit from exception of certain CFIUS reviews. (In case you haven't heard of the term, the Five Eyes refers to an intelligence alliance that includes Australia, Canada, New Zealand, the United Kingdom and the United States.)

"Today's actions reflect that our Five Eye allies have all stood up and implemented their own robust foreign investment screening programs," said Assistant Secretary for Investment Security Paul Rosen. "We look forward to continuing to coordinate with all of them on matters relating to investment security."

A BIG DEAL?

Former Head of CFIUS Thomas Feddo says the announcement is really just the Committee wrapping up what was essentially a "probationary period" on the excepted foreign state lists for two of the Five Eyes partners. "It would have been news if their status hadn't been finalized," he says. "Remember," he adds, "this is a very narrow exception for businesses based in these jurisdictions, a very high bar, so it really doesn't impact many parties."

Laura Black, former Director of Policy and International Relations at CFIUS, agrees with Feddo. "It would have been bigger news if the U.S. hadn't made this determination for the UK, after the UK identified and took action to address national security risks with respect to several transactions during its first year of operation."

Hogan Lovells partner Anne Salladin agrees. "No surprise here," she says.

Tyler McGaughey, who was previously Deputy Assistant Secretary for Investment Security at Treasury, calls the news a "medium" deal. "Being an investor from an excepted foreign state does not automatically guarantee that CFIUS will not have jurisdiction over certain deals," he says. In order to take advantage of a country's status as an excepted foreign state, the investor has to qualify as an "excepted investor," and the requirements for that are "pretty tough," says McGaughey, now at Winston & Strawn.

"But for any investor that can qualify as an excepted investor from an excepted foreign state," adds McGaughey, "the benefits are pretty good." Under those conditions, says McGaughey, CFIUS doesn't have jurisdiction over covered investments, and the investor is excluded from the mandatory process for control transactions. "In other words," he says, "for excepted investors, the CFIUS regime reverts to the pre-FIRRMA regime: they just have to worry about control transactions and, even then, the decision to file is entirely voluntary."

Stroock partner Chris Griner, who chairs the firm's National Security practice, agrees, adding that the announcement is "no great surprise, but it's still important." According to Griner, excepted foreign state status "can carry real benefits for investors, streamlining the CFIUS process."

DOES IT MATTER?

As Laura Black, now senior counsel at Akin Gump, recently told us, the Committee has been working hard to engage allies and partners to address transnational risks from certain foreign investment, "and to encourage and support national security focused investment reviews abroad."

That has led to more coordination and exchanging of best practices. According to Black, CFIUS has even been undertaking tactical engagements "and sharing actionable information with allies, subject to classification and confidentiality requirements," she said.

According to Holland & Knight partner Antonia Tzinova, the latest announcement regarding the UK and New Zealand sends a message that the Five Eyes stand united in their investment policies, and "creates an incentive for other allies to follow suit and synchronize their investment regimes with the U.S."

At the same time, while some foreign investors have indeed used the exception, Tzinova agrees with McGaughey that the test for a foreign excepted investor is still very high. As such, the EFS status can been seen as "more a political and diplomatic tool" than having an actual impact on foreign transactions. "It's like joining the club," she says.

"Being designated as an excepted foreign state signals to other countries and the rest of the world that you're serious about screening foreign investment," says McGaughey, "because the U.S. has given your investment screening regime a stamp of approval."

James Mendenhall of Sidley agrees that the significance is "largely political, as the exceptions identify states that cooperate with the U.S. Government most closely vis-à-vis China and other adversarial nations."

Nicole Kar at Linklaters says the UK is a good example. "I think for a regime like the UK's this significant," says Nicole Kar of Linklaters. "It's clear that CFIUS is happy with the enactment and subsequent implementation of the NSIA, and probably with the degree of back-channel cooperation between CFIUS and the ISU [UK Investment Security Unit]," she adds.

BEYOND THE FIVE EYES?

One reasonable question to ask then is — considering the increased engagement with international partners — why aren't there more excepted foreign states?

According to Tzinova, the requirements of a foreign government are significant. To "join the club," she says, the respective foreign country would need to implement a foreign investment screening mechanism that aligns with the U.S. CFIUS review process. "Some EU countries have revamped their investment regimes in response, like Germany or the Netherlands," she says, "but it would take some time for the U.S. to evaluate the effect."

David Ribner, counsel at O'Melveny, agrees with Tzinova's assessment. "While other countries, like Germany, have begun to implement foreign investment review processes to assess national security risks, there may not be sufficient processes in place yet to facilitate the necessary coordination with the United States."

"It makes sense that there are only a few excepted foreign states," says McGaughey at Winston & Strawn. "Lots of countries just started developing investment screening regimes," adds McGaughey, noting that the U.S. needs evidence that those regimes are working effectively before officially designating a foreign country as an excepted foreign state. "Developing that evidence takes time," he says.

Nicole Kar at Linklaters adds that the dearth of countries with EFS status may also be a reflection of those countries' abilities to share classified intelligence with the United States. "Other countries certainly have robust foreign investment regimes," she says, "but there may not be the same degree of CFIUS-foreign agency cooperation.

Stroock's Chris Griner agrees that Five-Eyes-level information-sharing remains the exception and not the rule. "More nations may become excepted foreign states in the future," he says, "but only if they have adopted a similarly strong investment screening regime, and fully cooperate in the sharing of sensitive information and intelligence with the U.S."

Tzinova also anticipates more countries being named excepted foreign states, eventually. "It is expected that more countries will be added," she says, "but the U.S. is carefully weighing the effects of the respective investment regime, and also is using as a diplomatic tool."

Former Treasury Dept. Assistant Secretary for Investment Security Thomas Feddo, now founder of The Rubicon Advisors, isn't so sure. That's largely because the EFS designation essentially removes certain transactions from the Committee's jurisdiction. "For that reason," he says, "I anticipate the list to remain rather short and reserved only for our closest allies – ones that have the most robust screening authorities and are clearly aligned with us on matters of geopolitical risk."

Feddo adds that there is an "over the horizon" risk if the U.S. were to add a foreign state and later determine the designation was not merited. "That could be embarrassing," he says. In addition, says Feddo, "it can be very difficult diplomatically, bureaucratically, to remove a name from a list."

Anne Salladin at Hogan Lovells agrees with Feddo's assessment. "I wouldn't expect new excepted foreign states in the near term," she says. "Whether and when to expand the group beyond the Five Eyes will take some time to assess."

Mendenhall at Sidley says that it will indeed take time for potential excepted foreign states to demonstrate to the U.S. government that they have "truly adopted a CFIUS-like regimen and met the requirements." Mendenhall adds that the necessary alignment is as much political as it is substantive, "and in today's globalized economy with many cross cutting, competing economic and strategic relationships, achieving alignment can be challenging and long-drawn-out."

WHAT GETS CONSIDERED?

So, what exactly does CFIUS consider when determining whether a country has established a "robust process" for being considered and excepted foreign state?

According to the Treasury Department's own determinations document, the Committee considers at least 10 factors, including topics such as:

- *MECHANISM* – Whether the foreign state has a review mechanism for foreign investment transactions "that is cross-sectoral and includes the defense industrial base, advanced technology, dual-use and military goods, network technologies, and critical infrastructure of the foreign state";
- *MONITORING & ENFORCEMENT* – The extent to which the foreign state monitors and enforces compliance by parties to a foreign investment transaction with conditions the foreign state has imposed on such transaction;

- *NON-NOTIFIED* – Whether the regime monitors and identifies foreign investment transactions even if the parties did not notify the foreign state government authorities;
- *CONFIDENTIALITY* – Whether the foreign investment review regime maintains the confidentiality of sensitive commercial information provided by the parties to transactions.

Please note the list above is not complete; refer to the Treasury Department's short two-pager on the topic.

POLITICAL MANEUVERING

One last item on the topic of excepted foreign states:

It's worth noting that U.S. Congressional leaders have tried to use the EFS status as a bargaining tool in foreign investment reviews.

For example, as readers may recall, back in November 2022, the UK government blocked the acquisition of British chip-making facility Newport Wafer Fab by Chinese-owned Nexperia. The deal had been under scrutiny for months, with considerable hand-wringing and attempted influence from America.

Concern over the deal ultimately led U.S. Congressional leaders to ask Pres. Biden to revoke the UK's excepted foreign state status if the deal went through. "Any approval of the NWF [Newport Wafer Fab] deal would necessarily call into question the fidelity of the UK's entire review process," the Congressional leaders wrote.

Those leaders, members of the China Task Force, had been urging the administration "to employ all tools necessary" to prevent the deal, "including engaging in direct diplomacy with the UK government." Among the tactics recommended was reconsidering the UK's status as an excepted foreign state by CFIUS. If the deal went through, the Congressional leaders recommended that the U.S. "immediately reconsider" the UK's status on CFIUS's whitelist, and apply "targeted export controls" on Newport Wafer Fab.

MORE INFORMATION

Last week's announcement from the Treasury Department is available, as is the Treasury Departments' running list of excepted foreign states. Treasury has also posted their factors for determining whether countries should get EFS status.

For an explanation of how CFIUS engages with foreign governments, please refer to our fantastic recent Q&A with Laura Black, who until recently was Director of Policy and International Relations at the Office of Investment Security at the Treasury Department.

Our 2020 coverage of the first excepted foreign states is available, as is our Jan. 2022 coverage of New Zealand's addition to the EFS list.

If you haven't heard of the Five Eyes or want to learn more, you can access the alliance's oversight and review counselat the Office of the Director of National Intelligence.

Quoted in this article, if you'd like to discuss further:

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