



Morgan Lewis

GLOBAL RESTRICTIONS

FOR INSTITUTIONAL INVESTORS

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COMPARATIVE ANALYSIS OF NATIONAL SECURITY REVIEWS IN THE UNITED STATES AND ASIA



Agenda

Update for the United States

- Reviews Under the Defense Production Act of 1950
- Impact of COVID-19 National Emergency on CFIUS Reviews
- Discussion of Select Issues

Update for China

- Market Entry Regulations for Foreign Investment
- National Security Review over Foreign Investment
- Cybersecurity Law, CIIO, and Data Transfer Restrictions

Update for Japan

- Framework of Amended Foreign Exchange and Foreign Trade Act (FEFTA)
- Exemption for Prior Notification of Acquisition of Stocks of Investee Company

Update for Southeast Asia and India

- ASEAN FDI Restrictions in Context
- Singapore
- Indonesia
- Malaysia
- Thailand
- Vietnam
- Philippines
- India (pre-DPIIT announcement and new DPIIT announcement)

UPDATE FOR THE UNITED STATES

A stylized globe with a digital grid overlay, glowing in blue and orange. The globe is composed of a network of lines and dots, representing a global network or data flow. The colors transition from a deep blue on the left to a bright orange on the right.

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Introduction

- The US has a long history of reviewing cross-border investment (FDI) to assess the national security implications of these types of transactions. With more than 20,000 to 40,000 cross-border investments a year, most transactions, however, occur outside the purview of US government review.
- The US maintains a robust and consistent process, managed by the Committee on Foreign Investment in the United States (CFIUS), to examine the implications of these types of investments. CFIUS began as an ad hoc Executive branch committee and has become an established, statutorily mandated review body.
- Congress amended the CFIUS process in 1988, 1993, 2007, and 2018. In each iteration, Congress further consolidated the Committee's authorities, expanded its jurisdiction, and identified the factors that matter to the US Government member agencies of CFIUS from a national security perspective.
- In August 2018, Congress passed and the President signed, the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) as part of the National Defense Authorization Act – the first comprehensive reform of the US FDI process since the 2007 Foreign Investment and National Security Act of 2007 (FISIA) amendments. FIRRMA confirmed CFIUS' authorities, continued to expand some of its jurisdiction and left the regulatory implementation to the Department of Treasury, in coordination with the Department of Commerce.
- The Treasury issued interim regulations in October 2018 (effective November 2018) and, subsequently, final regulations in February 2020. These regulations implement the first foundational changes to the CFIUS process since 2007.

Introduction

- FIRRMA confirmed a number of CFIUS' existing authorities as well as expanded the Committee's reach into areas where CFIUS previously reviewed cases, but not with the degree of clarity that investors expected.
- The changes included, but are not limited to:
 - Expansion of the review timelines from 90 days to up to 120 days
 - Establishment of a mandatory filing process for transactions that involve critical technologies and specific NAIC codes and "substantial" investments by foreign governments
 - Expansion of the factors that CFIUS considers when assessing the national security impact of a cross-border investment
 - Extension of CFIUS' review to non-controlling investments - i.e., those investments of any percentage, not just above or below a certain threshold
 - Establishment of "exceptions" to the non-controlling investment review process - for foreign governments (e.g., Australia, Canada, and the United Kingdom)
 - Fees for voluntary filings
 - Mitigation agreement expiration and reconfirmations
- FIRRMA and the regulations created a cascading effect - as CFIUS issued its regulations, developed its policies and interpretations, restructured its offices, and increased its resources, other countries changed their FDI review processes as well.

Reviews under the Defense Production Act of 1950, as amended

- FIRRMA also confirmed the breadth of industries and activities/investments that are subject to CFIUS' jurisdiction:
 - Bankruptcies
 - Debt foreclosure situations
 - Biotechnology investments
 - Nanotechnology investments
 - Sensitive personal data
 - Cloud computing
 - Semiconductors and electronics
 - Financial and insurance institutions
- For the first time ever publicly announced, CFIUS intervened before closing to block an attempted Broadcom hostile takeover of Qualcomm through the use of its interim authorities. There has also been increased use of CFIUS authority to force the divestiture of non-notified investments by foreign persons involving sensitive personal data (e.g., Grindr, PatientsLikeMe, TikTok).
- Before 2016, CFIUS had publicly blocked or required the divestiture of only a small number of foreign investments, principally involving Chinese State-Owned-Enterprises (SOEs) generally with military connections. The number of blocked or withdrawn transactions involving Chinese investors increased in the Obama Administration and has continued in the Trump Administration - centered in part on the changing geopolitical framework, publicly articulated Chinese technology development policy, and the Section 301 Investigation by the USTR.

Reviews under the Defense Production Act of 1950, as amended

- FIRRMA also required the President to expand his outreach to allies and partners in an effort to bring a more global and coordinated approach to cross-border investments.
- This mandate has resulted in a cascading effect across jurisdictions. This cascading effect has resulted in new or enhanced national security review regimes in Japan, Australia, the United Kingdom, the European Union, Germany, France, Italy, China, and Russia.
 - The increased activity by CFIUS has also been reflected by other governments that have intervened or rejected cross-border investments based on national security considerations.
 - Australia and Canada represent some of the more recent governments that have taken steps to block transactions.
 - In addition to rejection of pending transactions, the US, the UK, and Australia have each begun to examine closed transactions to determine whether concerns exist - and at the time the deals were cleared by the respective governments.
- This shift injects some uncertainty into the deal making process, calling into question the potential that completed deals may, nonetheless be subject to review. This uncertainty exists not only in the United States but in other jurisdictions where similar national security review processes exist.
- Deciding whether to file a notice to the CFIUS now requires consideration of the risks associated with not filing a voluntary submission but also the impact of failing to file a mandatory declaration, as well as the potential for filings in other jurisdictions.
- We expect to see increasing use by the administration of Executive Order authority to impose additional restrictions on foreign investment in key areas, including telecom and energy.

Impact of the COVID-19 National Emergency on CFIUS Reviews

- What is the effect of the COVID-19 crisis on the CFIUS process?
- CFIUS is still working, albeit remotely, and cases are still being cleared. This is not a government shutdown.
- Certain cases may take longer to clear because the remote working environment may slow down the internal review and approval process.
- Parties should expect greater scrutiny of transactions that involve a US business participating in the response to the COVID-19 crisis, whether related to a manufacturer of ventilators or Personal Protection Equipment subject to export restrictions or a business engaged in drug research and development for vaccines or therapeutic treatments.
- Given the circumstances, it is important to determine the role a US business may play in the COVID-19 emergency, the level of US government interest in, or supply chain concerns about the US business and any rated orders issued or other action taken under the DPA.

Impact of the COVID-19 National Emergency on CFIUS Reviews

- The COVID-19 crisis has also raised the specter of a potential increase in bankruptcies or other business disruptions.
- Bankruptcies, in particular, provide opportunistic investors the ability to access potentially key assets and US business that are currently in distress and require investment infusions.
- FIRRMA expressly confirmed that CFIUS has the authority to review FDI from a bankruptcy perspective and the bankruptcy courts are working with the Committee and other stakeholders to ensure that national security considerations are addressed in addition to creditors' equities.
- Bankruptcy sales must comply with CFIUS (as well as other export control and sanctions) requirements.

Changes to CFIUS Strategies

- Key changes to CFIUS Strategies:
 - Shifts in the due diligence process - i.e., questions to ask and documents to obtain
 - Establishment of more concrete deal terms prior to deciding whether to file a CFIUS notice
 - More “creative” deal structures to limit or preclude CFIUS’ review - more collaboration agreements without equity investments or restricted access to “critical technology”
 - Identification of CFIUS-type issues across jurisdictions
 - Due diligence on the purchaser - for example: compliance with US laws, compliance with sanctions, history of compliance overall, history of past CFIUS filings, foreign government support
 - Due diligence on the seller - for example: more robust export classification analyses, enhanced government contracts/subcontracts reviews, more documentation to understand liability transfers

Focus on TID Businesses

- Sensitive Personal Data used in defining a “TID business” - a new focus of CFIUS review.
- “Identifiable data” refers to data that can be used to distinguish or trace an individual’s identity.
 - Aggregated or anonymized data will be treated as identifiable data if any party to the transaction will have the ability to disaggregate or deanonymize the data.
 - It does not include encrypted data, unless the US business has the means to de-encrypt the data.
- Broad definition of sensitive personal data, focused on personal, financial, and healthcare information of US citizens, including identifiable data that is:
 - In applications for insurance;
 - Non-public email or messaging among users of a US business’s products or services;
 - Biometric data;
 - Geolocation data; or
 - Personnel security clearance data.
- “Identifiable data” will be treated as “sensitive personal data” if it is maintained or collected by a US business that:
 - Targets or tailors products or services to US security personnel including contractors; or
 - Has maintained or collected such data, or has a demonstrated business objective to do so, on more than one million individuals at any point in the preceding 12 months.

Focus on Sensitive Personal Data

- Sensitive personal data also includes genetic data.
 - Genetic data is not subject to the above two limitations on security personnel or minimum size of data population.
 - In an attempt to narrow the scope of genetic data covered, following concerns expressed regarding the proposed rules, CFIUS limited the definition in the final rules to “the results of an individual’s genetic test, including any related genetic sequencing data.”
 - Genetic tests are defined by reference to the Genetic Information Non-Discrimination Act of 2008.
 - Genetic tests covered are limited to identifiable genetic tests.
 - Excludes any data derived from US Government databases and given to third parties for research purposes.

Focus on Life Sciences Companies

- Foreign investment in life sciences and medtech products and services entities has been significantly affected by the new focus on and definition of sensitive personal data, as well as by the focus on these entities as essential under COVID-19.
 - Many life sciences and medtech product developers and manufacturers will have or intend to have access to data of one million or more individuals.
 - Certain life sciences companies, particularly those developing or manufacturing biotechnology-derived products or services, will have access to genetic test data.
- Foreign investment in healthcare service providers, including hospitals and healthcare insurers also may be significantly affected by this new focus, in view of the likelihood of collection and retention of data on more than one million individuals as well as of genetic test data.
- Foreign investment in the US food supply chain also likely will be affected by focus on these entities as essential under COVID-19.

Focus on Critical Infrastructure

- New, detailed definitions of critical infrastructure for determinations of covered control transactions and covered investments involving TID businesses.
- Two-step test: US business
 - Must relate to certain types of infrastructure.
 - Must perform certain specified functions for that infrastructure.
- A list of types of infrastructure and functions relating to them is set out in detail in Appendices to the final rules
 - Critical infrastructure includes electric energy systems, financial systems, rail networks, public water systems, petroleum and natural gas facilities, telecom and information networks, securities and exchanges and financial networks, and air and maritime ports.
 - Must consider both tests in making determinations (e.g., US interstate natural gas pipeline owner/operator is critical infrastructure; US business manufacturing or servicing the pipeline is not).
 - On May 1, the President signed a new Executive Order 13920 imposing additional restrictions on foreign investment by “adversaries” in the “bulk power” market.

Focus on Telecom Companies

- Most telecommunications network and service providers are now considered part critical infrastructure.
 - Telecom transactions may be reviewed additionally by the Committee for the Assessment of Foreign Participation in the United States Telecommunications Sector, created by Executive Order on April 4, 2020 (superseding the informal Team Telecom process).
 - The Executive Order is not expected to change the substance of prior Team Telecom reviews, but established new deadlines for the Telecom Committee’s review (90 days after submission of responses to questions and a possible additional 90 days), which will have to be taken into account by filing parties in conjunction with CFIUS review timelines.
- The detailed list in the separate CFIUS regulations on real estate should also be consulted to determine if any of the facilities in the target US business are in geographic proximity to military installations and other US Government sites of security concern and not covered by any available exceptions.

Strategies for Purchasers/Investors

- Strategies to consider for Purchasers and Investors (whether controlling or non-controlling)
 - Is the buyer/investor a foreign person for CFIUS purposes? Is it possible to structure the investment so as not to involve foreign persons (e.g., use of private fund exemption) that do not constitute evasion? Does the buyer/investor have a positive/negative track record with CFIUS?
 - Is it possible to structure the transactions so it is not subject to the mandatory filing requirements or a covered transaction? Examples include a license/collaboration agreement with no equity investment or a passive investment with no board/observer rights or access to “critical technology.”
 - If a mandatory filing is not required should closing be conditioned on CFIUS clearance because of national security risk profile (e.g., TID business, supply chain concerns, foreign government as an investor, US government nexus through contracts/funding)?

Mandatory Filing for Substantial Interest of Foreign Governments

- New mandatory filing requirement for foreign government–controlled transactions, where a “substantial interest” is acquired in a US business
 - If a foreign government–affiliated investor (from a single foreign state) would hold a 49% or more voting interest (direct or indirect) in the acquirer/investor.
 - And, the investment involves a 25% or more acquisition of a voting interest (direct or indirect) in a TID US business.
 - In the case of an investment fund, only the acquisition of interest in the general partner is considered (provided any limited partner interests do not confer control by the foreign investor).

Exceptions to Mandatory Filing Requirements

- What are the exceptions to the mandatory filing requirements under the new regulations?
 - Transactions by funds controlled by US nationals discussed more below.
 - Investments made by “Excepted Foreign Investors” (i.e., individuals, governments and private entities from Australia, Canada and UK).
 - An entity is exempted if:
 - It is organized under the laws of an excepted foreign state or in the US;
 - Such entity has its principal place of business in an excepted foreign state or in the US; and
 - 75% or more of the members and observers in the board of directors or equivalent governing body of such entity are: (i) US nationals; or (ii) Nationals of one or more excepted foreign states who are not dual nationals of any foreign state that is not an excepted foreign state (“Dual Nationals”).

Exceptions to Mandatory Filing Requirements

- Any foreign person that individually, and each foreign person that as part of a group, holds 10% or more of the outstanding voting or equity interests of such entity is (A) a national of one or more excepted foreign states and not a Dual National; (B) a foreign government of an excepted foreign state; or (C) a foreign entity organized under the laws of an excepted foreign state and that has its principal place of business in an excepted foreign state or in the US; and (D) the equity of such person is held by investors from that foreign state and who are not Dual Nationals.
- Investors from excepted foreign states may be disqualified for previous violations of export control or sanction laws or for having committed federal crimes.
- Investments by foreign entities operating under facilities security clearance and subject to a mitigation agreement to address FOCI executed with the DCSA.
- Investments in TID Businesses that produce, design, manufacture, test, fabricate or develop one or more critical technologies that may be exported under license exemption “ENC” under the EAR (i.e., most commercial encryption items).

Special Exception for Investment Funds

- How can I tell if my fund qualifies for the investment fund exemption?
 - Investment fund managers should determine if their existing funds qualify for the private equity exemption and design future funds, where possible, to qualify.
 - In order to qualify the general partner must not be a foreign person.
 - Neither the advisory board/committee of limited partners nor any foreign person may have the ability to approve, disapprove or otherwise control investment decisions or decisions made by the general partner related to the entities in which the fund is invested.
 - The foreign limited partners may not have control over the selection, dismissal, or compensation of the general partner.
 - No foreign limited partner may have access to material non-public technical information through membership on the advisory board/committee.
 - No foreign limited partner may be afforded access to any material non-public technical information in the possession of any TID US business in which the fund invests, or membership or observer rights on the board of any such TID US business or any involvement, other than through voting of shares, in substantive decisionmaking of the TID US business.

UPDATE FOR CHINA

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AGENDA

I Market Entry Regulations for Foreign Investment

II National Security Review Over Foreign Investment

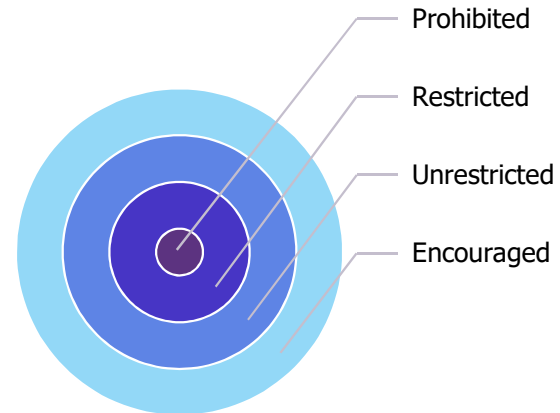
III Cybersecurity Law, CIIIO, and Data Transfer Restrictions



**PART I. MARKET ENTRY
REGULATIONS FOR FOREIGN
INVESTMENT IN CHINA**

Market Entry Catalogues for Foreign Investment

- Foreign Investment Law (“FIL”) and the Implementation Regulation for FIL (“FIL Implementation Regulation”) came into effect on January 1, 2020.
- The implementation of the FIL and the FIL Implementation Regulations represent China’s official establishment of a nationwide “**pre-establishment national treatment and negative list**” regulation system.
- Foreign investment in different sectors are therefore catalogued as Prohibited, Restricted, Unrestricted, and Encouraged, and subject to different regulatory treatment.



Market Entry -- Negative Lists

- The lists of “prohibited sectors” and “restricted sectors” for foreign investment are provided in Negative Lists.
- There are now two sets of Negative Lists under existing PRC law:
 - the *Special Administrative Measures (Negative List) for Foreign Investment Entry* (“National Negative List”), **applicable nationwide**; and
 - the *Special Management Measures for the Market Entry of Foreign Investment in Pilot Free Trade Zones (Negative List)*, **a more favorable list applicable to free trade zones only** (“FTZ Negative List”; together with National Negative List, collectively referred to as “Negative Lists”).
 - NDRC and MOFCOM amended the Negative Lists from time to time; the currently effective editions were amended and published on June 30, 2019 and effective on July 30, 2019.

Market Entry -- Negative Lists (Cont'd)

- In Negative Lists:
 - “**Prohibited sectors**”: any foreign investment in prohibited sectors - regardless equity ratio - is prohibited.
 - E.g. Development and application of human stem cells, gene diagnosis and treatment technologies.
 - “**Restricted sectors**”: foreign investment in any of the restricted sectors is subject to certain specific investment requirements (e.g. joint venture with Chinese partners, less than 50% shareholding, etc.) and subject to a prior approval by MOFCOM.
 - E.g. foreign-invested medical institution must be in the form of JV with Chinese partner.
- Foreign investments in other sectors that are not included in the Negative Lists are deemed **unrestricted**; they are generally treated equally with domestic investments on market entry.

Market Entry -- Encouraged Catalogue

- Chinese government also published a separate Encouraged Catalogue listed the **encouraged sectors** where foreign investment is welcomed.
- Foreign investors invest in sectors that are listed on the Encouraged Catalogue can not only be treated equally with domestic enterprises, but also be eligible for some preferential policies, such as tax incentives, discounted land prices, etc.
- A major focus of the current Encouraged Catalogue (effective on July 30, 2019) is to enhance support for high-tech manufacturing sectors.
 - E.g. in IT sector, foreign investment in 5G components, equipment for cloud computing and IC etching equipment are newly included into the Encouraged Catalogue.
 - E.g. Some areas in service sectors, such as the engineering and accounting services, e-commerce, AI and clean manufacturing, are also in the Encouraged Catalogue.

Market Entry -- Trends of Market Entry Restrictions

- **Shorter Negative Lists**

- National Negative List: 48 sectors prohibited or restricted (2018) ➡ 40 (2019)
- FTZ Negative List: 45 sectors prohibited or restricted (2018) ➡ 37 (2019)
- Further shortened Negative Lists are expected to be published in 2020

- **Predicted timeline for complete removal of foreign restrictions in certain sectors**

- E.g. according to China government's commitment in the 2019 Edition of the Negative Lists, securities, fund management, futures, and life insurance will be fully open to foreign investment (i.e. from 51% to 100% foreign ownership) by 2021.
- Acceleration in practice: since April 1, 2020, Chinese government has allowed 100% foreign investment in securities companies and fund management companies.



PART II.
NATIONAL SECURITY
REVIEW IN CHINA

National Security Review (NSR) Over Foreign Investment



Key updates

- **AML** generally provides a NSR regime for acquisitions of domestic companies by foreign investors.
- **2011 NSR Rules** specify more details on the substance of the NSR standards, procedures and implementing rules.
- **2015 FTZ NSR Rules** enhance NSR regime applicable for foreign investment in pilot free trade zones in China.
 - Extended the scope of covered transactions to all types of foreign investments (e.g. acquisitions, greenfield investments, JVs);
 - introduced a mechanism of conditional approval.
- **2020 FIL** elevates the NSR regime to the national law level and expands the scope of NSR to cover all types of foreign investments in China.

What Foreign Investments Are Subject to NSR –

A. Covered Transactions

- **2011 NSR Rules**

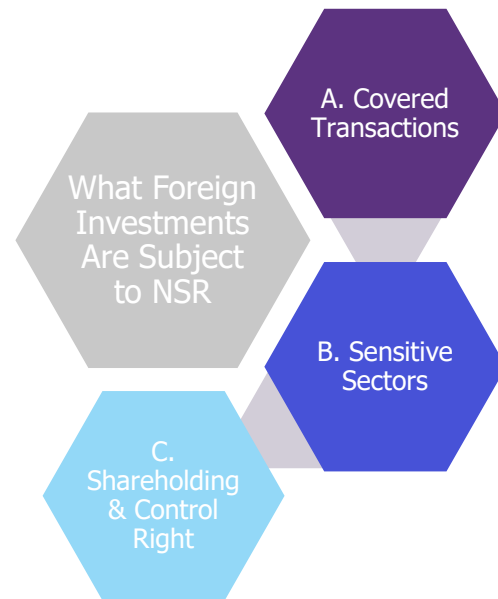
- Foreign investors' equity or asset acquisitions of domestic companies (direct or indirect), including disguised domestic investments that aim to circumvent NSR (*e.g. through nominee holding, trusts, multi-level reinvestment, leasing, lending, contractual arrangement or offshore structures*)
- Applicable nationwide

- **2015 FTZ NSR Rules**

- All types of direct or indirect foreign investments in China, *e.g. acquisitions, greenfield investments, JVs*
- Applicable only to the investment in pilot free trade zones in China

- **2020 FIL**

- Same as 2015 FTZ NSR Rules, i.e. all types of direct or indirect foreign investments in China (*e.g. acquisitions, greenfield investments, JVs*)
- Applicable nationwide



What Foreign Investments Are Subject to NSR –

B. Sensitive Sectors

- The existing law generally enumerates some sensitive sectors, though the definitions are quite broad; in practice, NSR agencies have authority to make a case-by-case decision:

2011 NSR Rules

- Defense Sector
- Some Other Sensitive Sectors: e.g. agricultural products, energy and resources, infrastructure, transportation services, key technologies and major equipment

2015 FTZ NSR Rules

- Additionally includes: culture and information technology
- Only applies within the FTZ

2015 National Security Law

- Identifies some more sectors as industries vital to national economy that should be protected by NSR regime
- e.g. finance, resources and energy, food safety, culture, technology, internet and cybersecurity, ecological and environment protection, nuclear power and nuclear technology, the exploration and use of outer space, international seabed areas and polar regions

2015 MOFCOM unpublished internal list

- In practice NDRC and MOFCOM also often refer to an internal list of key sectors
- over 60 specific sectors included in this unpublished list, e.g. medical equipment; retail

2020 FIL

- Silent on this issue, but it is expected that Chinese government would refer to the sensitive sectors under the 2011 and 2015 NSR Rules and the 2015 National Security Law when promulgating implementation rules for the NSR under the FIL.

What Foreign Investments Are Subject to NSR – C. Shareholding & Control Right

- For foreign investors' acquisitions in **defense sector**:
 - no shareholding % or control right requirement
- For acquisitions in **other sensitive sectors**:
 - 50% or more shares; *OR*
 - actual control right over the Chinese target companies
- Also note that the NSR agency considers the “actual control right” when deciding whether the acquirer is a foreign investor or not
 - E.g. in 2019's *Yonghui Supermarket's Proposed Acquisition of Zhongbai*, Yonghui was treated by NSR agency as a foreign acquirer because its Hong Kong parent company has actual control right over it (regardless the parent company only holds 19.99% equity interest)

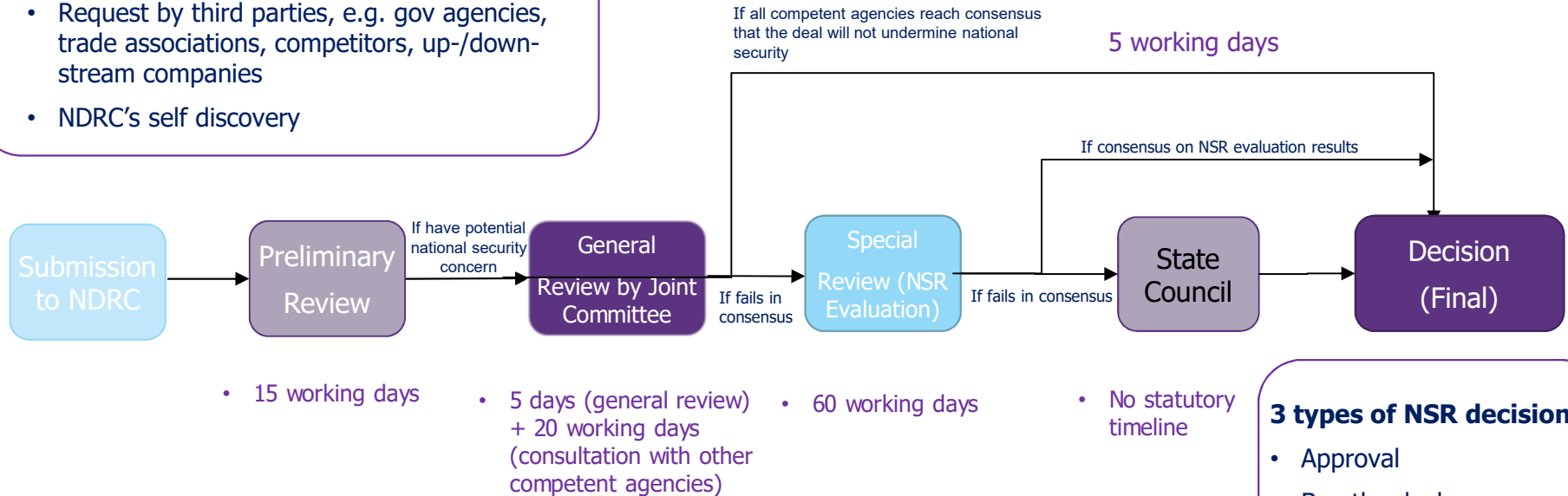
Agencies Responsible for NSR

- Since April 30, 2019, the authority of leading the national security review has transferred from MOFCOM to NDRC due to China's governmental reform.
- Specifically, NDRC is responsible for:
 - NSR consultation;
 - receiving NSR application;
 - chairing an inter-ministerial joint committee by coordinating with other competent authorities to review the cases.
- An inter-ministerial joint committee composing of relevant competent agencies will be organized on a case-by-case basis.
- After NDRC's preliminary review, qualified cases will be submitted to joint committee for general review, and further for special review if needed.

General Procedures of NSR

3 ways to trigger a NSR:

- Voluntary filing by transaction parties
- Request by third parties, e.g. gov agencies, trade associations, competitors, up-/down-stream companies
- NDRC's self discovery



3 types of NSR decisions:

- Approval
- Ban the deal
- FTZ Rules: Conditional approval

Focuses of National Security Review

- The focuses of national security review provided under existing PRC law are quite general, which leaves great discretion to NSR agencies:
 - **2011 NSR Rules**
 - impact on defense and security
 - impact on economic stability
 - impact on social order
 - impact on R&D capabilities of critical technologies that have a bearing on national security
 - **2015 FTZ NSR Rules**, additionally includes:
 - impact on cultural security/public morality
 - impact on cybersecurity

Practices of NSR Enforcement in China

– Not Quite Transparent

- PRC law does not require NSR agencies to publish their reviews and decisions to the public.
- Nor do Chinese agencies produce annual reports as the CFIUS committee does.
- In general, the NSR enforcement is not quite transparent in China, and it is unknown to the public how many cases that Chinese NSR agencies have actually reviewed or challenged for national security reasons.

Practices of NSR Enforcement in China

– Case Study

- **Yonghui Supermarket's proposed acquisition of Zhongbai**

- In August 2019, Yonghui received a notice from the NDRC requesting information on the acquisition
- In September 2019, NDRC initiated a national security review over this proposed acquisition
- In November 2019, the NSR forwarded to a special review stage
- In December 2019, the NSR ended up with Yonghui's drop of the acquisition

- **Takeaways from Yonghui Case**

- NSR agency considers the “actual control right” when deciding whether the acquirer is a foreign investor, e.g. a HK parent company owns 19.9% shares and actual control right of Yonghui
- The specific business and consumers of the Chinese target may make the acquisition in a sensitive sector
 - Retail sector is not clearly listed in 2011 and 2015 NSR Rules as a sensitive sector
 - Whilst no official confirmation from the NDRC, it is suspected that the primary concern was Zhongbai's essential role as the major provider of warehousing and distribution services for the 2019 Military World Games in October 2019 and Zhongbai's store network in certain military colleges in Wuhan.

Key Takeaways re. China's National Security Review



- **Trend of Enforcement**

- China's NSR is becoming more critical
- No express indication re heightening the national security scrutiny during the COVID-19
- But caution a retaliation mechanism under the FIL

- **Recommendations**

- Conduct a self-assessment and seek advice from PRC legal counsel before investing
- Approach Chinese authority for consultation meeting and plan ahead to save sufficient time for NSR
- Include national security approval as a CP to the transaction, or set long-stop terms in the transaction agreements



**PART III. CYBERSECURITY
LAW, CIIO & DATA TRANSFER
RESTRICTIONS IN CHINA**

China's Cybersecurity Law (CSL) and national security reviews

- CSL came into force on June 1, 2017
- CSL applies to all network operators
 - including all organizations that provide services or products over the internet or other information networks in China
 - including internal networks and systems such as the company's HR systems
- CSL imposes restrictions of national security reviews from the following perspectives:
 1. Security assessment for cross-border data transfer
 2. National security reviews for the procurement of network products and services by CIIOs
 3. Security obligations under Multi-Level Protection Scheme (MLPS 2.0)

Data localization and cross-border data transfer

- Under Article 37 of CSL, CIIOs are required to store personal data and important data within PRC territory. In case of a cross-border data transfer, CIIOs are subject to a security assessment conducted by the Cyberspace Administration of China (CAC). Cross-border data transfers that may bring risks to the national security, public interests or data subjects' rights are not allowed.

CIIO

Entities in critical information infrastructure industries whose damage, loss of function or data leakage of their network system would seriously harm China's national security, national economy, people's livelihood, and public interests

Personal Information

Information that could "identify" a person or be "linked" to a person, such as a person's name, address, telephone number, date of birth, identity card number and biometric identifiers (including employee's information)

Important Data

Data that if disclosed, would impact national security, economic security, social stability, public health and safety, such as non-public government information, significant volumes of data related to finance, population, genetics and health care, geographic, and mineral resources

Data localization and cross-border data transfer

Examples of CIIs:

- The CSL provides examples of CII, including network operators in the areas of public communications, information services, energy, transportation, water utilities, finance, public services, and e-government, but leaves the specific definition of CII to the regulations to be made by the State Council.
- The Regulation for the Security Protection of the Critical Information Infrastructure (Consultation Draft) defines the scope of CII by listing operators in certain industries, including
 - government agencies and entities in the energy, finance, transportation, water conservation, healthcare, education, social insurance, environmental protection, and public utilities sector;
 - information networks, such as telecommunication networks, broadcast television networks, and the Internet, and entities providing cloud computing, big data, and other large-scale public information network services;
 - research and manufacturing entities in sectors such as science and technology for national defense, large equipment manufacturing, chemical industry, and food and drug sectors; and
 - press units such as broadcasting stations, television stations, and news agencies.

Data localization and cross-border data transfer

Examples of important data in 27 industries and sectors:

- oil and natural gas, coal, petrochemical industry,
- electric power, telecommunications, electronic information,
- iron and steel industry, nonferrous metals,
- equipment manufacture, chemical industry,
- national defense, other industries that have national security implications,
- geographic information,
- civil nuclear facilities, transportation, post express, water conservancy,
- population health, finance, credit, food and medicine, statistics, meteorology,
- environmental protection, broadcasting, marine environment,
- e-commerce,
- a catchall category for any other data in any other area that may affect the peace, prosperity, or social welfare of China.

The definitions, scope, and identifying criteria of important data in these key industries may be further specified by the competent industry regulators or regulatory authorities.

Data localization and cross-border data transfer

- A legislative trend - draft regulations, such as the Measures for Security Assessment for Cross-border Transfer of Personal Information, extend data localization requirements to all network operators.
- If draft regulations come into force, all network operators should conduct a security assessment before transferring personal data and important data outside China.
 - “Network operator” is more broadly defined than CIIO.
 - MNCs’ use of networks in China to transfer data within an internal cross-border network may also constitute a cross-border transfer, such as data transfers between the domestic subsidiary and oversea headquarter.
 - Foreign entities that are not registered in China may also be required to perform a security assessment for cross-border data transfer if they provide products or services within China.
 - Consideration factors include: whether Chinese language is used, whether the payment is made in CNY, and whether the products or services are delivered to China.
 - Foreign entities should fulfill the obligations through their legal representatives or institutions in China.

National security reviews

2017

CSL provides a general rule that “any purchase of network products and services by CIIO that may affect the national security is subject to the national security review conducted by the CAC and competent departments of the State Council.”

2020

Measures on Cybersecurity Review released by 12 government authorities aimed to implement a comprehensive national security review system targeting at network products and services used by CIIO (to come into effect on June 1, 2020)

Key requirements

- Before purchasing network products and services, CIIOs must undergo national security reviews if the procurement affects or may affect China’s national security.
- It is aimed to detect and eliminate the potential cybersecurity risks in the supply chain of the CIIOs and thus to safeguard the national security.
- CIIOs and their suppliers are required to sign security and confidentiality agreements, under which the suppliers are obligated to provide cooperation for the national security reviews, including, making commitments not to (i) illegally collect CIIOs’ data, or illegally control or manipulate CIIOs’ equipment via the supplied network products and services, or (ii) interrupt the supply of products or necessary technical support services without justified reasons.

National cybersecurity reviews

Review Criteria

- if the risk arising from the use of the network products or services will cause CIIOs to be unlawfully manipulated, interfered or destroyed, or lead to the leak, loss, or damage of important data;
- if there will be continuous damages to CII business due to supply disruptions of the products or services;
- the security, openness, transparency and diversity of sources, reliability of supply channels, and any risk of supply disruptions resulting from “political, diplomatic, and trade” factors;
- if the product or service provider is in compliance with Chinese regulations;
- a catch-all provision covering all other situations that could endanger CII security and national security. It seems that the CAC will have ample discretion in determining potential risks in a particular procurement.

Multi-Level Protection Scheme (MLPS 2.0)

- Network operators are required to classify their network and information systems into different levels based on the level of importance of their network systems to national security, economic and social life, with 1 being the least sensitive, 5 being the most.
- The higher the ranking, the more monitoring by MPS as well as third-party certification, MPS filing, and annual reviews.
 - Level 3, the point at which self-certification turns into government reviews, happens when damage to the networks would, among others, “cause serious harm to social order and the public interest, or cause harm to national security.”
 - Networks rated level 3 and above are required to put in place enhanced policies and procedures, such as cybersecurity monitoring, detection and response, and incident notification to relevant authorities.
 - The national security reviews for CIIOs also extend to level 3 network operators: they are required to conduct national security reviews for the procurement of network products and services if they may affect national security.
 - They will be inspected by government officials at least once a year.
 - Their networks must also be technically maintained in China rather than remotely maintained from overseas. If work must be done from overseas, it must undergo a cybersecurity review and be logged in case of inspection.

Key Takeaways



- **Know your data.** Assess the scope of data during early case assessment, including, incorporating steps to identify and categorize the data during data collection and transfer.
- **Localize the data.** Whenever possible, collect, filter and review data in the PRC, or at the very least, filter and screen the personal data and important data in China before transferring them. To prepare for the security assessment for cross-border data transfer, execute and implement data transfer agreements between entities/offices.
- **Conduct self assessment for national security reviews.** Companies operating in China, especially those in manufacturing, finance, medical, food, healthcare, telecommunications, energy, transportation sectors, should conduct a self-assessment regarding whether they are considered as CIIOs. IT and tech vendors that supply network products and services to customers in these sectors should also evaluate whether their customers are CIIOs, which may cause the procurement of network products and services to be affected by national security reviews.
- **Prepare for MLPS requirements.** Conduct a self assessment and consider the MLPS requirements when setting up data centers in China.

UPDATE FOR JAPAN

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Framework of Amended Foreign Exchange and Foreign Trade Act (FEFTA)

**Further promote FDI
conductive to sound
economic growth**



Introduction of exemption for “prior notification for stock purchases” of an investee company

**Ensure proper review
of FDI that could pose
risk to national
security**

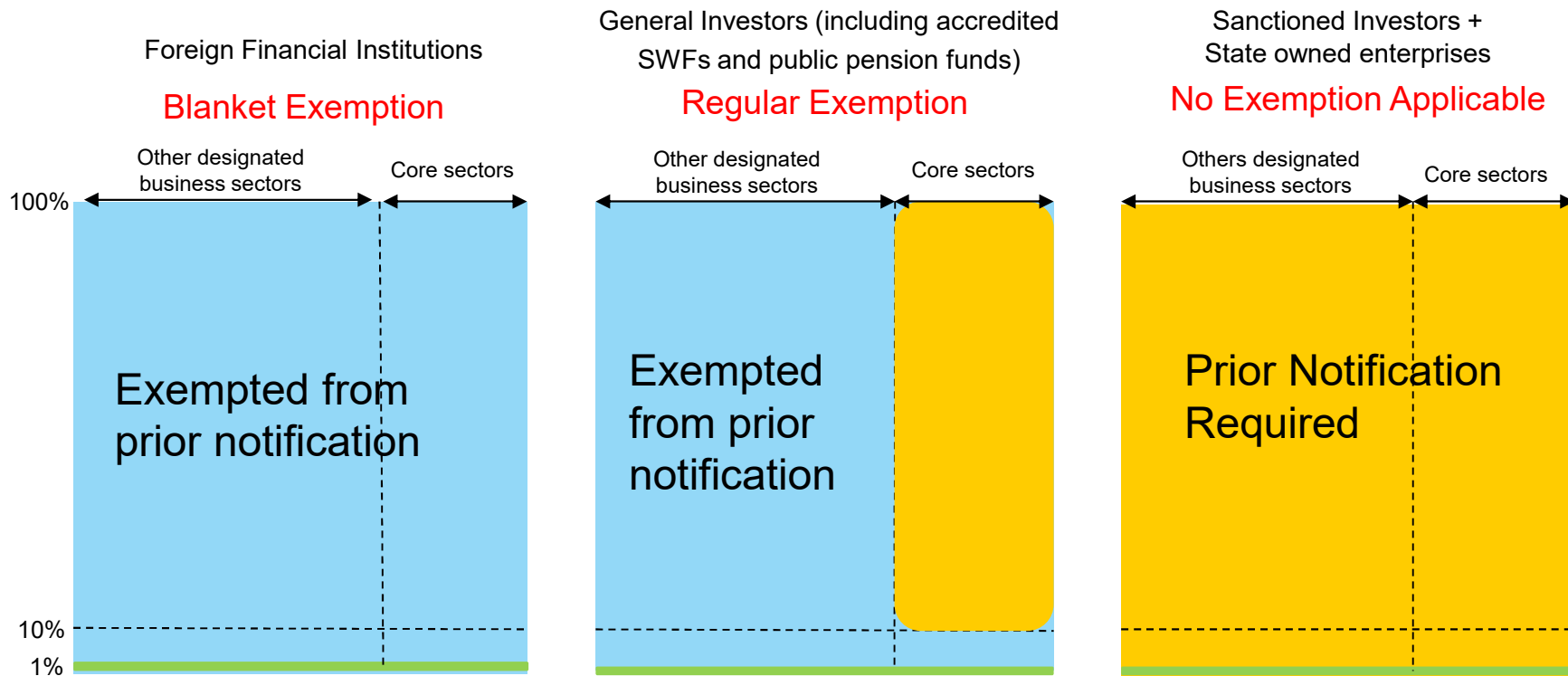


Threshold for prior notification is reduced from 10% to 1%

Prior notification is required:

- if a foreign investor or its closely related person will become a member of the board of the investee company
- if a foreign investor will propose the transfer or disposition of investee company's business activities in the designated business sectors

Exemption for "Prior Notification for Stock Purchases" of Investee Company (1) – Overall Structure

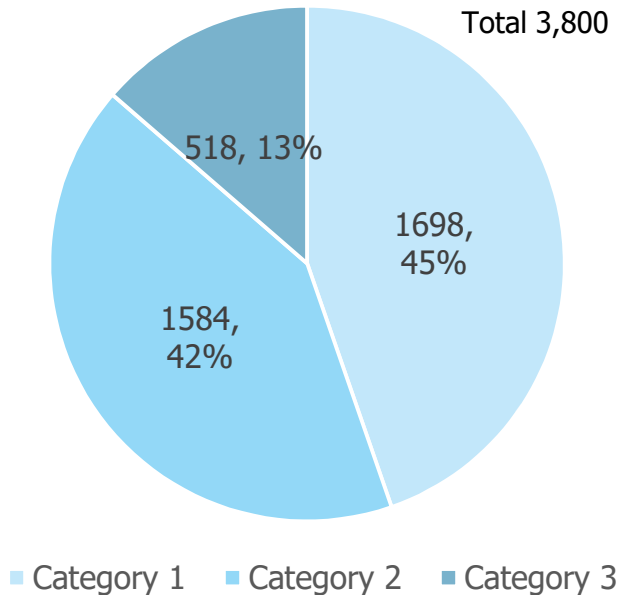


Exemption for “Prior Notification for Stock Purchases” of Investee Company (2) - Designated Business

Industry	Category	Industry	Category	Industry	Category
Weapons	Core	Gas	Partially Core	Passenger transportation	Non Core
Aircrafts	Core	Telecommunication	Partially Core	Biological drug manufacturing	Non Core
Aerospace	Core	Water supply	Partially Core	Security	Non Core
Nuclear power	Core	Railway	Partially Core	Leather related	Non Core
General purpose products which are able to diversify for military use	Core	Oil	Partially Core	Agriculture, forestry and fisheries	Non Core
Cybersecurity	Partially Core	Heat Supply	Non Core	Air transportation	Non Core
Electric power	Partially Core	Broadcasting	Non Core	Shipping	Non Core

Exemption for “Prior Notification for Stock Purchases” of Investee Company (3) – Companies Classification

Listed Companies' Classification



- List of Companies' Classification for Notifications was published on May 8, 2020.
- Classification Categories:
 - 1: Non-designated business sectors
 - 2: Designated business sectors (Non-Core)
 - 3: Designated business sectors (Core)
- Medicines and advanced medical equipment are considered to be added to core business sector.

Exemption for “Prior Notification for Stock Purchases” of Investee Company (4) – Investors & Exemptions

Types of Investors	Designated Business Sectors	Scope
Foreign financial institutions	Non-core	Blanket Exemption <ul style="list-style-type: none"> • Prior notification exemption with no upper limit for investors that comply with the Exemption Conditions • Post-facto investment report from 10%
	Core	
General investors (including SWFs and public pension funds accredited by the authorities)	Non-core	Regular Exemption <ul style="list-style-type: none"> • Prior notification exemption with no upper limit for investors that comply with the Exemption Conditions • Post-facto investment report from 1%
	Core	<ul style="list-style-type: none"> • Prior notification exemption under 10% for investors that comply with the Exemption Conditions and the Additional Conditions • Post-facto investment report from 1%
Investors with a record of sanction due to violation of the FEFTA State-owned enterprises (except accredited enterprises)	Non-core	No exemption is available.
	Core	

Exemption for “Prior Notification for Stock Purchases” of Investee Company (5) – Exemption Conditions

- **Exemption Conditions**

- a. Investors or their closely related persons will not become board members of the investee company;
- b. Investors will not propose the transfer or disposition of investee company’s business activities in the designated business sectors at the general shareholders meeting; and
- c. Investors will not access non-public information about the investee company’s technology in relation with business activities in the designated business sectors.

- **Additional Conditions**

- d. For business activities in core sectors, investors will not attend the investee’s companies’ executive board or committee meetings that make important decisions in these activities; and
- e. For business activities in core sectors, investors will not make proposals, in a written form, to the board of directors or the executive board of the investee companies or these members requiring their responses and/or actions by a set deadline.

Prior Notification and Post-Facto Investment Report

- **Prior Notification**

- Once a foreign investor obtains clearance from the authorities, such foreign investor will be permitted to purchase stocks up to the notified amount anytime within 6 months after submission of the prior notification.

- **Post-Facto Investment Report**

- Post-Facto investment reports must be submitted within 45 days from the transaction settlement date.
- Post-Facto investment reports will be required when the foreign investor's total shareholding reaches:
 - (1) 1% (when reaching 1% at the first time);
 - (2) 3% (when reaching 3% at the first time); and
 - (3) 10% or more (post-facto investment reports will be required for each transaction)

Prior Notification for Certain Actions

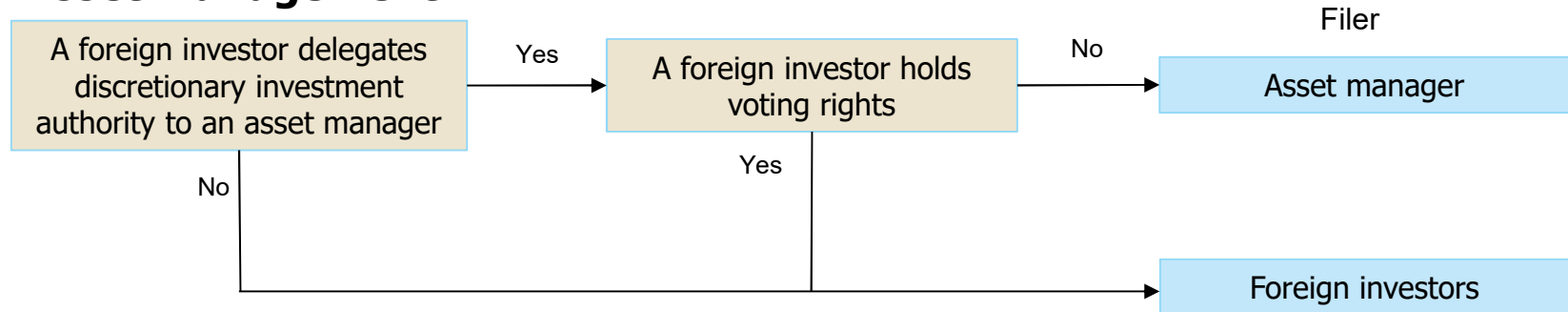
- The following actions by foreign investors are added to the definition of FDI subject to prior notification:
 - voting for nomination of the foreign investor itself or its closely related person as a board member of the investee company at the shareholders meeting; and
 - making a proposal, or voting for a proposal to transfer or dispose the investee company's business activities in the designated business sectors at the shareholders meeting.
- Foreign investors who intend to take these actions can conduct so if prior notification for these actions is filed and cleared.
- When the prior notification is reviewed and there is no concern from national security perspectives (e.g., no leakage of information about critical technologies and disposition of business activities in the designated business sectors), the authorities will notify the investor of clearance of the screening within five business days.

Reporting Obligations in Investment Fund Structure and Asset Management Structure

- **LP Fund**

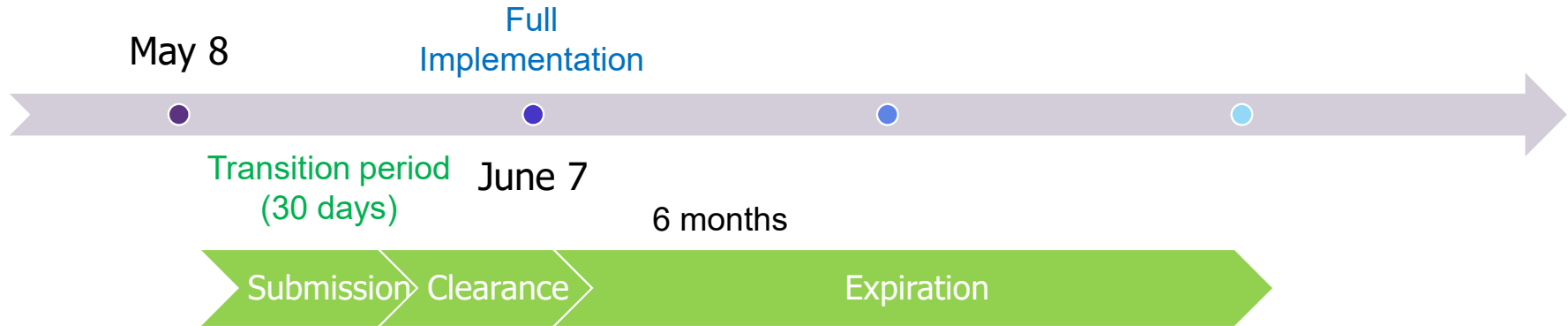
- Where (a) foreign investors hold investments of 50% or more in the assets of a partnership and (b) the GP of that partnership is a foreign investor, that partnership will be categorized as a specified partnership and the GP will be entitled to make filings in the name of the partnership.

- **Asset Management**



(Note) If a foreign investor partially holds voting rights, both asset manager and foreign investor will be a filer.

Next Steps in Implementation Schedule



- The amended FEFTA became effective on May 8 with a 30-day transition period commencing on such date.
- During this transition period, foreign investors are expected to submit a prior notification if they plan to purchase 1% or more of the shares of a Japanese public company.
- It is expected that foreign investors will use the 6 month period to make adjustments to their IT systems as necessary to comply with the new regulations.

UPDATE FOR SOUTHEAST ASIA AND INDIA

EDWARD BENNETT

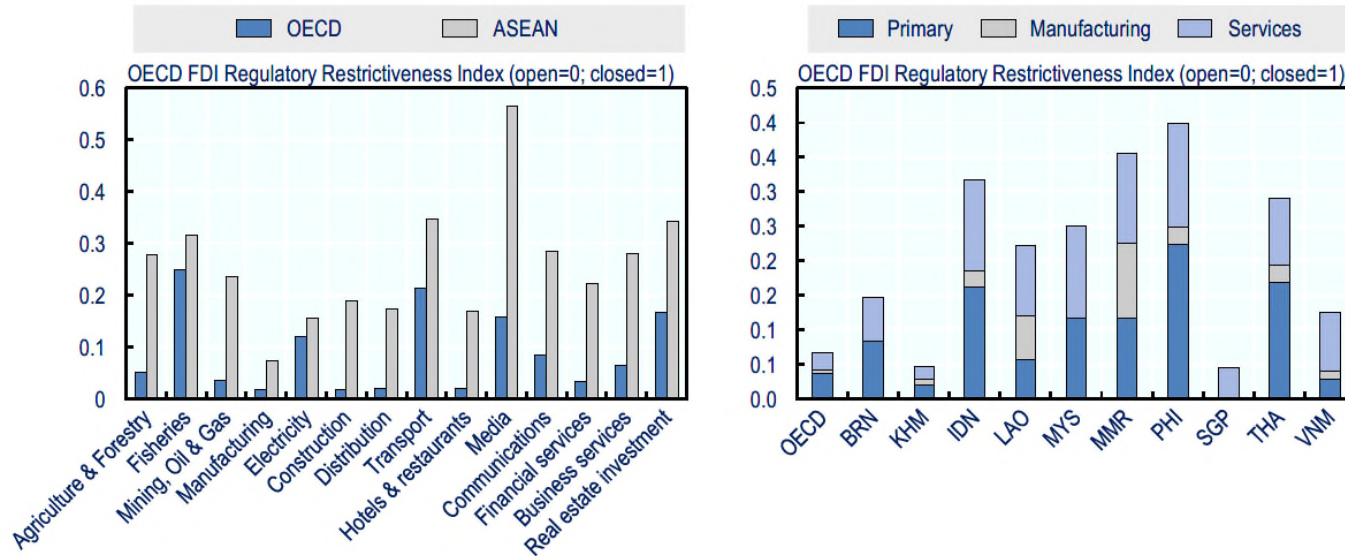
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ASEAN FDI Restrictions in Context

Figure 2.2. FDI restrictions by sector, ASEAN versus OECD members

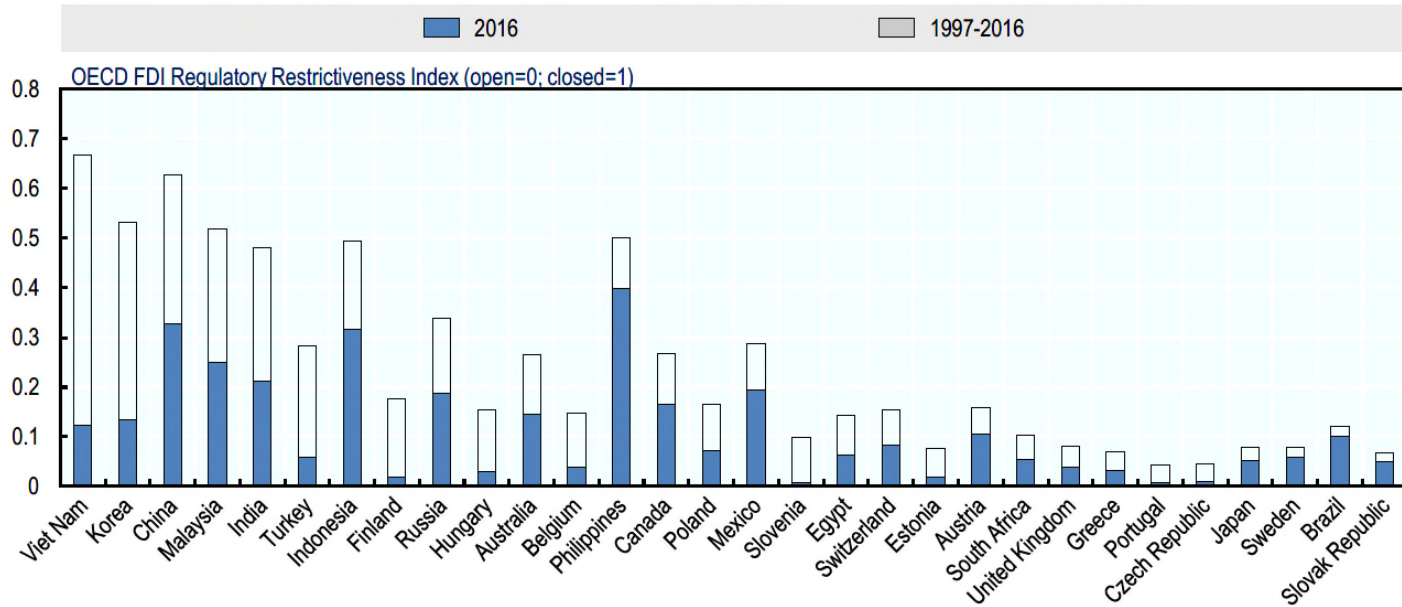
(Panel A - by sector; & Panel B - sector contribution to overall score)



Note: See Box 2.1 for a description of the *FDI Index*.

Source: OECD FDI Index database, www.oecd.org/investment/fdiindex.htm

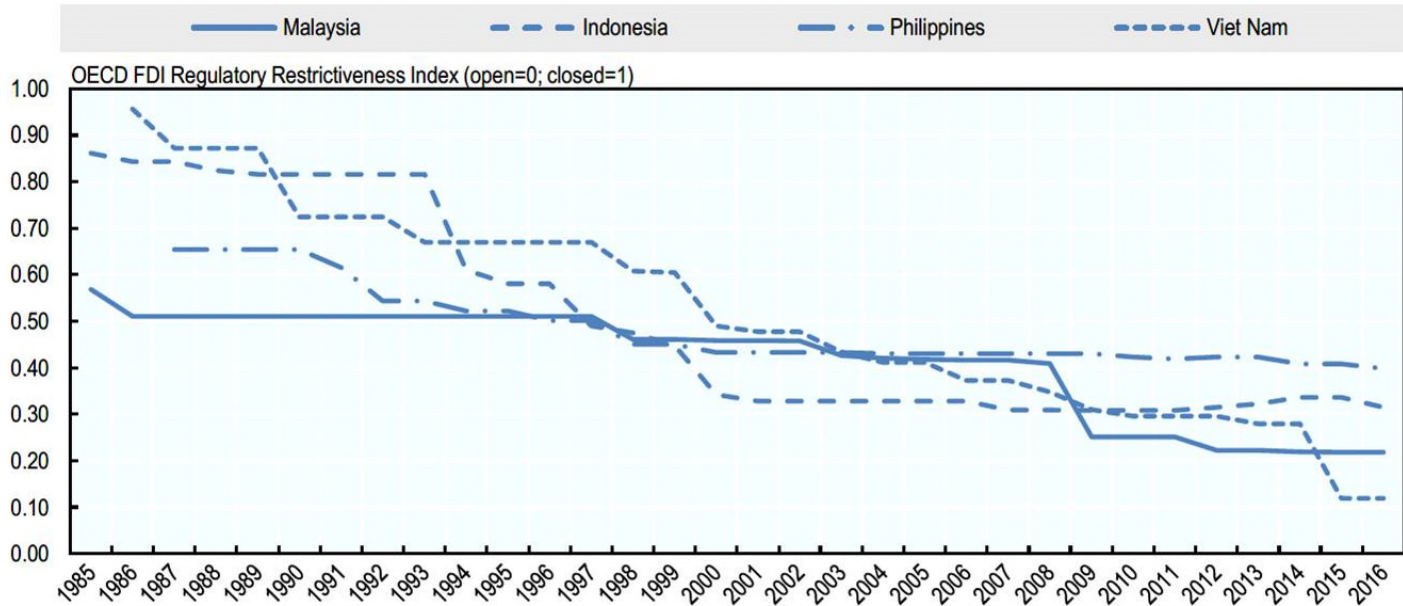
Figure 2.3. ASEAN members are among the top FDI reformers since 1997



Note: See the description of the *FDI Index* in Box 2.1. The sample of countries is restricted to those covered in the 1997 *Index*; only the top 30 reformers are shown.

Source: OECD *FDI Index* database, www.oecd.org/investment/fdiindex.htm

Figure 2.4. FDI liberalisation trends in selected AMS



Note: The historical series might not perfectly match the current Index score due to slight methodological accommodations made to ensure consistency overtime.

Source: OECD (2018) *Investment Policy Review of Viet Nam* (forthcoming).

Singapore

- Generally no restrictions on foreign ownership and investment in Singapore save for certain sector specific restrictions (telecommunications, media, banking and real estate industries).
- Restrictions take several forms:
 - Restrictions on the level of shareholding permitted to be held by a foreign shareholder
 - Requirement to be licensed by the relevant Singapore authority
 - In addition to the general anti-trust merger control regime, requirements to obtain consent by the relevant Singapore authority for any acquisition above certain thresholds in a licensed Singapore entity
- **No cross-sector 'national security interest' restrictions**

Indonesia

- Direct foreign investment is permitted subject to sectoral restrictions:
- (i) identified in Presidential Regulation No. 44 of 2016 regarding List of Business Fields Which Are Closed and Conditionally Open for Investment (Negative List); and/or
- (ii) contained in industry specific regulations (for example, pertaining to financial services, oil and gas etc)
- Negative List identifies business sectors prohibited outright or otherwise subject to certain restrictions, such as maximum shareholding levels / requirements that foreign investors enter into a partnership with certain local businesses.

Indonesia (cont...)

- If business sector not on Negative List, generally understood to be open to 100% foreign investment without conditions although, in practice, prudent to consult the relevant authorities (such as the Investment Coordinating Board (Badan Koordinasi Penanaman Modal or BKPM)) to determine any additional conditions
- In addition, all foreign investment must be made through a limited liability Indonesian company permitted to have foreign shareholders (PMA Company), which is establish to conduct a particular stated line of business
- **No cross-sector 'national security interest' restrictions or regime**

Malaysia

- Generally, minimal restrictions except for the certain sector specific restrictions (communications and multimedia, petroleum, distributions and insurance). These can take the following forms:
 - Restrictions on the level of shareholding permitted
 - Requiring minimum ownership by indigenous ethnic groups in Malaysia (Bumiputera)
 - Licensing/consent requirements from the relevant Malaysian authority

Malaysia (cont I...)

- Certain sector-specific restrictions:
 - **Trading:**
 - MDTCA requires all proposals for foreign participation in “distributive trade” to obtain prior approval. Includes hypermarkets, department stores, superstores, specialty stores and franchise systems
 - Foreign investment in certain distributive trades prohibited (including provision shops and convenience stores, fuel stations, medical halls, newsagents etc)
 - Where approval granted, usually subject to specific conditions: (i) requirements to appoint Bumiputera directors; (ii) formulating policies and plans to assist Bumiputera participation; (iii) hiring personnel at all levels to reflect the racial composition of the Malaysian population

Malaysia (cont II...)

- ***Manufacturing:***
 - Manufacturing companies (except those with shareholders' funds less than RM2.5m (approx. USD600k) or less than 75 full-time paid employees) are required to be licensed by the Ministry of International Trade and Industry
- ***Petroleum:***
 - Petronas owns and controls the entirety of Malaysia's petroleum resources. It licenses upstream activities and usually requires local and Bumiputera equity ownership in its counterparties
- **No cross-sector 'national security interest' restrictions or regime**

Thailand

- Foreign investor restrained from engaging in restricted business activities set out in Foreign Business Act without specific approval from the relevant local authority or an exemption applies.
- Restricted business activities listed under the FBA fall into 3 categories:
 - Absolute prohibition (for example, newspaper businesses, radio and television broadcasting, agriculture and farming businesses)
 - Related to national safety and security (for example, production of weapons) and therefore prohibited without approval from the Cabinet of the Thai Government
 - Not open to foreign competition unless approved by the Thai Ministry of Commerce

Thailand (cont...)

- In addition, sector specific laws may impose foreign ownership restrictions (e.g. under the Financial Institutions Businesses Act, the ownership ceiling for FIs is 25% subject to exceptions granted by the Bank of Thailand, which can raise the ceiling to 49% in specific cases)
- **No cross-sector 'national security interest' restrictions or regime**

Vietnam

- Generally permitted in all sectors subject to:
 - Absolute prohibitions in certain specified sectors under the Law on Investment (LOI) (trading of specified pharmaceuticals, trading of specified chemicals and minerals or trading of specified specimens of wild fauna and flora)
 - Vietnamese government holds monopolies in certain sectors (national railways, airports, public postal services, lotteries and publishing (excluding printing and distribution))

Vietnam (cont...)

- Sovereign rights reserved to restrict investment in certain 'conditional sectors' (listed in the LOI) so that investors, whether foreign or local, must satisfy conditions for purposes of national defence and security, social order and safety, social ethics and community health
- Right also reserved to impose further conditions, such as: (i) foreign ownership limits; (ii) requirement for local partners; (iii) operational requirements; and/or (iv) conditions stipulated in international treaties to which Vietnam is a party (e.g. Schedule of Specific Commitments in Services contained in Vietnam's WTO accession package, with ASEAN investors subject to less restrictive conditions)
- **No cross-sector 'national security interest' restrictions or regime**

Philippines

- Foreign ownership and investment permitted subject to restrictions listed under the Foreign Investments Act (FIA)
- FIA contains 2 lists (List A and List B) which are updated on a periodic basis
- The restrictions contained in the lists are as follows:
 - **List A:**
 - Activities reserved to Philippine nationals by way of:
 - (i) outright prohibition against **any** form of foreign investment in specific sectors (including professional services, media and security services); or
 - (ii) restrictions on the **level** of foreign ownership in specific sectors (including advertising, private radio communication networks and private recruitment)

Philippines (cont...)

- **List B:**
 - Activities and enterprises regulated for reasons of security, defence, risk to health and morals and protection of small and medium-sized enterprises
 - Provides restriction on foreign ownership (i.e. up to 40%) for the activities listed (including, for example, manufacturing and distribution of dangerous pharmaceuticals and gambling, unless otherwise exempted by the relevant authorities)
- **No** cross-sector 'national security interest' restrictions or regime

India (pre-DPIIT announcement)

- FDI is generally permitted subject to the following:
 - Absolute prohibition in certain sectors (for example, nuclear energy, railway operations, gambling and lottery businesses and manufacture of tobacco products)
 - Restrictions in certain sectors such that shareholdings beyond a certain stipulated level are either prohibited (insurance and pensions) or require regulatory approval (print media, telecoms, banking and defence-related sectors)
 - Additional conditions may apply in certain sectors depending on the applicable regulations

India (pre-DPIIT announcement cont...)

- Other than FDI, foreign investors may invest via other established routes which are each subject to their own set of rules and restrictions:
 - **Foreign Venture Capital Investors (FVCI)**: Registered with SEBI and allowed to invest in certain types of local companies (Asset Finance Companies and Infrastructure Finance Companies) and in certain sectors (such as biotechnology, nanotechnology, IT related hardware and software development etc). FVCIs can invest in start-ups in such sectors without being subject to restrictions otherwise imposed on FDIs; or
 - **Foreign Portfolio Investment (FPI)**: Investments in capital instruments representing either: (i) less than 10% of the post issue paid-up equity capital on a fully diluted basis of a listed Indian company; or (ii) less than 10% of the paid-up value of each series of capital instruments of a listed Indian company. Where FPIs exceed the 10% limit as applicable, they are reclassified as FDIs and subject to the general restrictions
- **No** cross-sector 'national security interest' restrictions or regime, **BUT...**

India (new DPIIT announcement)

- On 17 April 2020, DPIIT announced new limitations to existing foreign direct investment rules:
 - any company, located in a country that shares a land border with India, will require government clearance before it can invest in India
 - rules will also apply to **owners of firms**, citizens of such countries, and might benefit from such investments
 - investors based in Pakistan, Afghanistan, Bhutan, Nepal, Myanmar **and China** will have to abide by these rules
 - restrictions were already applicable to Pakistan and Bangladesh and investments from Afghanistan Myanmar, Nepal and Bhutan were negligible
 - Related factors:
 - SEBI required custodians to disclose, at very short notice, all investments from China
 - People's Bank of China's increased its stake in HDFC bank >1%
 - Perceived as pre-emptive measure against Chinese takeover of Indian firms struggling in face of COVID-19 economic downturn

India (new DPIIT announcement cont...)

- Detail of rules yet to be published, but key immediate observations:
 - Trade deficit has been widening: India seeks re-balancing through sales of pharma/IT
 - Much at stake: Chinese investment in India's technology-driven businesses in 2018, totaled US\$5.6 billion, x5 increase from 2016; Indian government has also already indicated HK will be included
 - New rules do not distinguish between 'greenfield' and 'brownfield' investments
 - No *de minimis* threshold, but unclear how beneficial ownership (e.g. Chinese minority investors in offshore non-Chinese funds) will actually be determined
 - China has labelled measures "discriminatory"
 - **As a cross-sectoral measure:**
 - if viewed as a non-'national security' restriction, goes against OECD's preferred sector-specific 'negative list' approach
 - if viewed as a *de facto* 'national security' restriction, depending on the detail of the rules (TBC), goes against OECD's 4 key principles (proportionality, transparency, predictability, accountability)
 - Though motivated by domestic considerations, new rules may fail to protect India's long-term strategic interests – a US CFIUS-style regime or EU FDI screening framework would arguably have been of more benefit and enabled agility to adapt

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THANK YOU

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