



Morgan Lewis

M&A ACADEMY

CROSS BORDER REGULATORY ISSUES

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Introduction

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Conducting Risk-Based International Compliance Due Diligence in M&A Transactions

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Key International Compliance Risk Areas and Associated Liabilities

1. Anti-Corruption (FCPA and UK Bribery Act, as well as applicable local anti-corruption laws)- liabilities can include criminal and civil fines, jail time for individuals, debarment, deferred prosecution agreements or consent decrees, follow-on civil litigation
2. Sanctions Laws (US and EU- Iran, Syria, North Korea, Cuba, Venezuela, Crimea, Ukraine-related Russian sanctions, blocked persons or SDNs and other OFAC programs) –liabilities can include criminal and civil fines, jail time for individuals, debarment, deferred prosecution agreements or consent decrees.
3. Export and Re-Export Laws (US and EU)--liabilities can include criminal and civil fines, jail time for individuals, denial of export privileges, deferred prosecution agreements or consent decrees.

Key International Compliance Risk Areas and Associated Liabilities

4. Anti-Boycott Laws (US) – liabilities can include criminal and civil fines and loss of tax benefit.
5. Customs/Import Compliance and Trade Actions/Remedies -- liabilities can include increased duties, penalties and forfeitures, exclusion of products from the United States, follow on civil litigation, including FCA claims.
6. National Security (CFIUS/Exon Florio/FOCI/NISPOM) – liabilities can include blocked transactions, loss of government contracts, debarment, suspension of exporting and other privileges, criminal and civil fines as well as intangible penalties, such as mitigation agreements or other proscriptions. For transactions involving difficult national security issues, transaction delays can occur.

Trump Effect

Since President Trump took office in January 2017, he has pursued a number of actions that have had or will potentially increase the risks associated with international activities:

1. Threatened to withdraw from international trade agreements and initiated or emphasized the importance of trade remedy actions to protect US markets, as well as announcing “Buy American and Hire American” initiatives. On January 22, 2018 tariffs imposed under Section 201 on washing machines and solar panels.
2. Tightened sanctions on Cuba and Iran; imposed sanctions on Venezuela; signed new sanctions legislation tightening sanctions on Russia, Iran and North Korea; increased sanctions on North Korea and Iran and threatened to withdraw from the JCPOA creating potential tensions between the US and its allies; extended secondary sanctions by naming certain Chinese banks for their facilitation of trade with North Korea.
3. Tightened the national security analysis (Exon-Florio/CFIUS) of cross-border investments, particularly for foreign companies whose governments have articulated policies that concern the US Government; this has affected transactions with Chinese, Russian and other companies in or that may be directly or indirectly involved with these countries; in some case this has increased the detailed information required, and the need for more in-depth review has resulted in more withdrawals and re-filings as parties attempt to devise mitigation to save their transactions; Congress has indicated a renewed interest in modernizing CFIUS with at least 6 new bills introduced related to the CFIUS process and substantive review.
4. Continued enforcement of FCPA with emphasis on voluntary disclosures by companies and prosecution of individuals.

Recent DOJ Guidance on Corporate Compliance in M & A Transactions

In February 2017, DOJ released guidance on how it evaluates corporate compliance generally and noted these questions that it will ask specifically in the M & A context .

- **Due Diligence Process** – Was the misconduct or the risk of misconduct identified during due diligence? Who conducted the risk review for the acquired/merged entities and how was it done? What has been the M&A due diligence process generally?
- **Integration in the M&A Process** – How has the compliance function been integrated into the merger, acquisition, and integration process?
- **Process Connecting Due Diligence to Implementation** – What has been the company's process for tracking and remediating misconduct or misconduct risks identified during the due diligence process? What has been the company's process for implementing compliance policies and procedures at new entities?

Successor Liability

- In certain areas of international compliance, including the FCPA, sanctions and export and import controls there is clear precedent establishing the liability of the buyer for misconduct of the target company occurring before the closing under the theory of successor liability.
- In the FCPA area, DOJ/SEC have provided specific guidance in the joint 2012 FCPA Guide how to minimize successor liability.
- In the trade area, the Department of Commerce began asserting successor liability in 2002 in the *Sigma Aldrich* case.
- The Department of State has a long history of imposing strict successor liability on companies who purchase entities that committed violations prior to the acquisition. *See Consent Agreement with L-3/Goodrich; Consent Agreement with General Motors/General Dynamics; Consent Agreement with L-3/Titan; Consent Agreement with Meggitt USA, Inc.; Consent Agreement with Multi-Gen Paradigm*
- In the customs areas, successor liability was found in the following cases: *Shields Rubber Corp* (1989), *Ataka America* (1993), *Adaptive Microsystems* (2013) and *CTS Holding* (2015).

DOJ/SEC Guidance -FCPA

According to the DOJ/SEC, to avoid successor liability for FCPA violations a purchaser must:

1. Conduct thorough pre-acquisition risk-based FCPA due diligence on the target.
2. Ensure that, post-acquisition, the acquiring company's policies and procedures are applied to the target as quickly as practicable.
3. Train personnel (including, in some cases, agents and business partners) at the target on anticorruption laws and company policies.
4. Conduct an FCPA-specific audit during post-closing integration.

DOJ announced its new "FCPA Corporate Enforcement Policy" on November 29, 2017. The new policy makes the FCPA voluntary disclosure pilot program permanent and takes the additional step of creating a "presumption" of non-prosecution where companies "voluntarily self-report the issue, cooperate fully with prosecutors, and identify and remediate the root causes and gaps in compliance controls that led to the problem."

DOJ/SEC Guidance --FCPA

- The DOJ also suggests that parties use the Opinion Release procedure for M&A transactions. While Justice has issued several opinion releases in the M&A context, this process can be time consuming and may, according to the DOJ, contain more stringent requirements that may be necessary in all circumstances.
- It is important to emphasize that while, by following the above advice, you may be able to avoid or minimize successor liability for the acquiring company, you will not avoid the liability for any past FCPA violations of the target company being acquired, and such liability can materially adversely affect the value of the proposed investment.

Risk-Based Due Diligence

- There is very little guidance on what level of risk-based international compliance due diligence is required for a particular target and the scope of due diligence will depend upon the amount of time and resources you have available and the particular international compliance risks associated with the target.
- There is a fundamental difference between responding to a governmental enforcement action or pursuing an internal investigation, on the one hand, and performing M&A due diligence on the other.
- While the client or deal team will want you to estimate potential exposure it is very difficult to do that accurately because of the wide range of potential monetary and non-monetary liabilities and long -5 year-statute of limitations. It is particularly challenging when the target has limited compliance programs in place and may have unknown violations.

Risk-Based Due Diligence

- Government enforcement cases and internal investigations focus on discovered conduct that may be a violation. Internal investigations may require intensive document review and analysis, electronic mail collection, and witness interviews. Depending upon the subject matter, this process may take many months and even years, especially if the Government is concerned that the conduct at issue has jeopardized an important national security or foreign policy interest.
- In contrast, risk-based international compliance due diligence attempts to identify the international compliance risk areas of a target in a relatively short period of time – often with limited access to critical documents and personnel.

Risk-Based Due Diligence

The risk assessment should focus on the following:

1. The nature of the target's business and reputation in the market.
2. The industry and the countries in which the target operates.
3. The extent to which the target is exposed to certain international compliance risk areas and how it approaches compliance in these areas.
4. The extent to which the target utilizes third parties in dealing with customers and regulators.
5. The extent to which the target interacts with government officials or has government customers.
6. The strength of the target's existing compliance program and internal controls.

Practical Approaches

1. Choose your team wisely: The international compliance due diligence team should include those subject matter experts (SME) best suited to address the specific issues involved in a transaction. These include transaction and regulatory counsel with experience in the field, as well as in-house personnel from the legal, finance and compliance departments. Some cases may benefit from third party consultants with a specific expertise tailored to the risks at issue. Each team varies somewhat and a cookie cutter approach generally increases the costs of the transaction.
2. Understand what you need to investigate or review and the timeline: Determine the amount of time, scope of international compliance due diligence and allocation of responsibilities. Transactional lawyers focus on the high-level areas of risk given the target's business model and international operations; regulatory counsel provides laser focused input on the areas where greatest or most consistent risk exists; the in-house compliance department can supplement the assessment provided by outside counsel or SMEs; and the finance department focuses on books and records and accounting controls, including any material weaknesses in internal controls.

Practical Approaches

3. Understand what can be obtained through the data room: Because information concerning international compliance issues is rarely included in publicly available materials or in a data room, it is critical to create a separate work stream to conduct international compliance due diligence. Often a supplemental international compliance questionnaire is submitted followed by one or more interviews of the target's compliance and business personnel to understand the international compliance risks and to focus on areas for further inquiry.
4. Address violations or noncompliance up front and in the deal documents: If enforcement cases or internal investigations are discovered or disclosed, it may be necessary to bring in outside counsel skilled in the legal issues involved (*i.e.*, an SME) to assess the potential impact on the target and its business/value pursuant to a common interest agreement to try to prevent waiver of the privilege (recent case law suggests common interest agreements may be ineffective).

Practical Approaches

5. Understand the risks and where additional diligence is needed: One of the biggest challenges in conducting due diligence is determining when a desk-top review or interview of target personnel may be insufficient and when certain potentially high-risk transactions should be audited in more detail. This kind of audit can be very time consuming and international compliance issues are often difficult to detect without a full investigation.

Practical Approaches

6. Prepare to deal with foreign affiliates or subsidiaries: Most transactions involve international activities or parties. Your transaction may involve a target's foreign subsidiaries, foreign suppliers or vendors or foreign consultants and customers. Uncovering potential violations in any of these situations where foreign parties may be involved presents an additional challenge. Privacy requirements, the extraterritorial effect of US laws and regulations as well as interpretative consistency may hamper the diligence process.
 - Note that, to the extent there is a limited opportunity to conduct pre-acquisition international compliance due diligence, it is essential to conduct more in-depth post-acquisition international compliance due diligence to eliminate ongoing compliance problems. Also critical is the integration of the acquired company into the acquiring company's international compliance program.
 - Note also that if you are representing non-US acquirers export licenses may be required to conduct due diligence on controlled technologies or non-US persons screened from the due diligence process.

Key Diligence Questions

Key risk areas to focus on include the following:

1. Is the target in a high-risk industry?

- For example, the target or its competitors are in an industry of particular focus for US governmental authorities and there have been enforcement cases involving the target or its competitors.
- Industry examples: Oil and Gas, Telecommunications, Medical Devices, Pharmaceuticals
- **Diligence Goal**: Understand the regulatory environment and enforcement patterns to plan diligence resources and effort.

Key Diligence Questions

2. Does the target operate in a high-risk country?

- For example, the target is located in or operates in a country that has a reputation for corruption.
- Locations of concern include countries such as China, Brazil, Argentina, India, Indonesia, The Philippines, and other countries with poor scores on the Transparency International Corruption Perceptions Index.
- Locations of concern can also vary depending on the target's industry.
- **Diligence Goal:** Understand the target's business model, including its ethics culture, compliance structure, and methods for operating in challenging ethical environments.

Key Diligence Questions

3. Does the target have extensive international sales, foreign subsidiaries or many points of contact with foreign government officials (or politically exposed persons)?

- For example:
 - The target has an Asian subsidiary focusing on a market consisting of many government customers.
 - The Asian subsidiary is managed by a foreign national who has significant family contacts in the government.
 - The target has multiple business-related licenses issued by various levels of government.
- **Diligence Goal:** Understand and apply the level of diligence effort necessary to reasonably assess risk.

Key Diligence Questions

4. Does the target rely on the use of third-party intermediaries to make sales or to handle government relations? Are you able to easily identify the target's third parties in its records and accounting systems?

- For example:
 - The target relies heavily on third-party intermediaries with success fees or other incentive compensation.
 - The target has third parties involved in handling government relations activities, including obtaining critical permits/regulatory approvals.
 - Contracts with third parties do not have FCPA clauses, or they have limited provisions, and there is little evidence that third parties have been trained in the FCPA.
- **Diligence Goal:** Identify and evaluate high-risk intermediary activities and the target's pre-engagement diligence on and continuing oversight of third parties.

Key Diligence Questions

5. Does the target rely on business gifts and entertainment, including travel, as well as charitable and political contributions as part of its sales and marketing?

- For example:
 - The target's sales representatives have a history of being reimbursed for significant sales and marketing expenses without appropriate documentation.
 - Many customers have been reimbursed for travel.
 - Significant charitable or political contributions have been made in other countries (potentially for purposes of market access).
- **Diligence Goal:** Assess (i) whether the business has been built on a foundation of corrupt activities, (ii) the strength of the target's accounting controls, and (iii) the cultural risks inherent in the business.

Key Diligence Questions

6. Does the target export products, technical data or services that are subject to the export control jurisdiction of the US Department of State?

- The US State Department controls the permanent and temporary export and temporary import of defense articles, defense services and related technical data (items). The items subject to State Department jurisdiction are included in the US Munitions List (USML) found in the International Traffic in Arms Regulations (ITAR).
- Exports of USML products, technical data and services require licenses from the State Department's Directorate of Defense Trade Controls (DDTC) unless an ITAR exemption applies. The ITAR also includes lists of countries for whom exports or temporary imports are prohibited or otherwise subject to a presumption of denial.
- If the target exports, designs, develops, modifies, adapts, uses or manufactures USML items, the target is required to:
 - register with DDTC and
 - provide certain notifications to DDTC before the closing (in the case of non-US acquirers) or after closing (in the case of US acquirers).
- **Diligence Goal**: Determine the target's ITAR obligations to assess target's ITAR compliance.

Key Diligence Questions

7. Does the target export products or technology that are subject to US export control jurisdiction of the US Department of Commerce?

- The US Department of Commerce has export licensing jurisdiction for dual use products and technology – items that have a civil and military application - that are included in the Commerce Control List (CCL) included in the Export Administration Regulations (EAR).
- Exports of products or technology may require product-specific licenses from the Commerce Department's Bureau of Industry & Security (BIS) unless an EAR license exception applies.
- Exports destined to certain countries, certain end users and certain end uses may also separately require BIS export licenses.
- **Diligence Goal:** Determine the target's EAR obligations to assess target's EAR compliance.

Key Diligence Questions

8. Has the target been granted any export licenses from DDTC or BIS or used any DDTC or BIS export exemptions / exceptions?

- Target is required to comply with:
 - all export license provisos and any other license conditions.
 - the terms of all relevant export license exemptions / exceptions
- How does the target monitor compliance with license provisos, license conditions and license exemptions / exceptions?
- Have any of the target's export license applications been denied?
- Have any of the target's export licenses been denied, revoked or suspended?
- Did target obtain any Commodity Jurisdiction determinations (CJs) from DDTC or any Commodity Classification Rulings (CCATs) from BIS in support of the proper jurisdiction for the export licenses that target secured?
- Are target's export licenses transferrable with minimum interruption to the business?
- **Diligence Goal: Assess target's compliance with export license and export exemption / exception requirements under ITAR and EAR.**

Key Diligence Questions

9. Does the target conduct business in or engage in any business dealings involving countries subject to OFAC sanctions without the requisite OFAC authorization (specific license or general license)?

- It is critical to determine whether the target conducts business in, facilitates business in or engages in any unauthorized activities involving OFAC sanctioned countries, as such unauthorized dealings constitute OFAC violations.
- OFAC country sanctions apply primarily to "US Persons" but do in certain instances apply extraterritorially.
- In addition to primary country sanctions, OFAC also maintains secondary sanctions which require no US nexus.
- OFAC country sanctions are subject to implementation or modification without notice.
- The Statute of limitations for OFAC violations is five years.
- **Diligence Goal:** Assess the target's potential exposure to OFAC violations incurred via current or past dealings in or with OFAC sanctioned countries.

Key Diligence Questions

10. Does the target conduct business with or engage in any business dealings involving OFAC sanctioned parties?

- It is critical to determine if the target conducts business with, facilitates business with or engages in any business dealings involving OFAC sanctioned parties, as such dealings constitute OFAC violations.
- OFAC considers sanctioned parties to include those parties that are 50% or more owned by a sanctioned party.
- To the extent that the target comes into possession of a sanctioned party's assets, the target is required by OFAC to block such assets and file a report with OFAC regarding the asset blocking.
- OFAC sanctions are subject to implementation or modification without notice.
- The Statute of Limitations for OFAC violations is five years.
- **Diligence Goal:** Assess the target's potential exposure to OFAC violations incurred via current or past dealings with OFAC sanctioned parties.

Key Diligence Questions

11. Does the target conduct business in or with any “boycotting” countries?

--The US has laws and regulations that prohibit compliance with the Arab boycott of Israel (and all other unsanctioned boycotts) and imposes both substantive prohibitions and reporting obligations. To complicate matters there are two sets of boycott regulations – the Treasury and Department of Commerce Regulations – and they are not entirely consistent.

-- **Diligence Goals:** Determine if the target does business in any “boycotting” countries and assess the target’s exposure to anti-boycott violations.

Key Diligence Questions

12. How dependent is the target's business on imports?

If the target's business is dependent on imports to any significant degree, it is important to assess the extent to which the target's import program involves any imports of:

- products produced using prohibited or forced labor such as slave labor, convict labor, indentured child labor, and labor by North Korean nationals and citizens without regard to country of residency
- products subject to pending trade remedies or actions, such as antidumping or countervailing duty, Section 201 or Section 337 cases or other quantitative restrictions
- products made as preferential duty entries (Free Trade Agreements), duty deferral or duty exemption entries
- products that are subject to US Customs and Border Protection audits / enforcement / seizure cases for misclassification or underpayment of duties

Compliance Goals: Determine if the target's import program is subject to potential disruption by events beyond target's control.

Key Diligence Questions

13. How strong are the target's compliance policies and compliance culture, including the tone at the top?

- For example:
 - The target has an underfunded compliance program which appears to be a document taken off the shelf and not customized to its business.
 - The target has a newly adopted compliance program.
 - Training and auditing are infrequent and the tone at the top is focused on the achievement of sales objectives.
 - There is little or no use of a company reporting “hotline” or other reporting mechanisms.
 - There are no compliance cases or sanctions imposed on anyone for violating the company's code of conduct.
- **Diligence Goal:** Understand the target's compliance culture and assess the nature of the target's compliance policies and procedures

Key Diligence Questions

14. How cooperative is the target with the diligence process?

- For example:
 - The target is slow to produce compliance related documents – whether licenses, exception/exemption records, license proviso implementation records, voluntary disclosures or copies of audit reports.
 - The target has numerous documents produced in the local language only.
 - Internal experts are uninformed concerning key diligence areas.
- **Diligence Goals**: Determine whether a lack of cooperation reflects compliance weaknesses that require enhanced diligence inquiries in one or more areas. Consider engaging diligence specialists for targeted diligence efforts.

Key Diligence Questions

15. Does the target have any ongoing internal or government investigations or has the target voluntarily disclosed any international compliance concerns that are currently pending government review?

- For example:
 - The target has disclosed the existence of a government investigation or subpoena.
 - The target has produced compliance hotline reports reflecting international compliance allegations.
- **Diligence Goal:** Understand nature of the allegations, exposure, employee and third-party involvement, affected business units, and current control environment.

Use Of Due Diligence

Once the risk-based international compliance due diligence is concluded, you need to assess the effect of what you have found on the overall transaction. Options include:

- (a) proceeding as planned or renegotiating to account for risks,
- (b) delaying closing until further due diligence is done or active cases/investigations are resolved and then reassessing or renegotiating, or
- (c) walking away.

Use Of Due Diligence

Questions to consider include:

1. How much of the target's revenue stream/business model could be affected?
2. How many key employees, intermediaries, or customers may be affected or need to be retrained or terminated?
3. Is the target's business model/culture so different that it will be difficult to integrate it into your compliance program without the business being materially affected?
4. How much uncertainty is there concerning whether you have had sufficient time to assess compliance risks or to resolve known compliance issues and quantify associated costs and liability?
5. Can identified risks be addressed through contractual provisions or revaluation? Or are they so serious that they should be resolved prior to closing?

Need for Specialized Contract Provisions

- It is market practice to include specialized FCPA and other international compliance representations and warranties in transactional documents and not to rely on general compliance with laws representations and warranties, which are often qualified with no material adverse effect language.
- These specialized representations and warranties serve two purposes; first, to force disclosure of compliance issues and, second, in private company transactions where representations and warranties survive the closing, to set up special indemnities, which may be secured by special escrows.

Considerations for Sellers

Sellers should consider the following with respect to international compliance issues:

1. Prepare due diligence for buyers by doing a self-assessment of ongoing compliance issues, including hotline complaints, internal investigations, or external enforcement cases.
2. Prepare any required disclosure information and determine at what time and in what manner to disclose it to buyers.
3. Be prepared for a discussion with buyers concerning the potential materiality of international compliance issues in terms of purchase price adjustments in public deals where representations, warranties and indemnities do not survive the closing or special escrows in private deals where they do.
4. Be prepared for a requirement by buyers that the international compliance issues be disclosed to enforcement authorities as a condition of closing.
5. Consider use of representation and warranty insurance to avoid tying up funds post-closing.

Considerations for Buyers

Buyers should consider the following with respect to international compliance issues:

1. Prepare due diligence plan and allow for adequate time where possible; do not let the sellers delay disclosure until the 11th hour.
2. Adjust the due diligence plan and resources depending upon what is learned; address any export licensing requirements in due diligence phase.
3. Discuss with sellers and buyers' own counsel potential materiality of international compliance issues and level of uncertainty.
4. Consider adequacy of proposed special escrows in private deals where issues have been identified.
5. Consider whether forcing disclosure to enforcement authorities will lead to timely resolution of international compliance issues before closing.
6. Prepare pre-acquisition the post-acquisition international compliance integration plan.
7. If the target is a public company, consider SEC disclosure obligations and potential issues relating to material weaknesses in internal controls.

CFIUS in the Investment and Acquisition Decision Process

- Assess at an early stage whether a filing with CFIUS is warranted in considering potential US investments and acquisitions.
- Evaluate and include the CFIUS review process in corporate agreements and transaction timelines.
- Assess cybersecurity protections/policies and geographic proximity to US security installations.
- Evaluate utility of early engagement with CFIUS and other appropriate government officials to reduce the potential for security objections to be raised.
- Consider buyer-seller protections (e.g., reverse break-up fees; CFIUS clearance as condition precedent or as only a condition).

When is CFIUS Review a Consideration?

- CFIUS can review “covered transactions”
 - defined as *any transaction* a foreign person or entity’s acquisition of control of a US business with products or services that present a national security concern.
 - Foreign Person — any “foreign national, foreign government, foreign entity,” or “any entity over which control is exercised or exercisable by a foreign national, foreign government, or foreign entity.”
 - Includes acquisitions of control in US companies or entities with foreign parents or significant foreign shareholders
- US Business – An existing business, not a “greenfield” investment, or acquisition of patents or technology licenses
 - Low threshold

Clearing Transactions with CFIUS

- Current Situation
 - Increased activity, more Chinese transactions and chronic staffing issues enhanced existing challenges within CFIUS
 - The US maintains an “open door” policy regarding FDI and that policy is generally managed by Treasury, the US Trade Representative and Commerce
 - This “open door” policy is counterbalanced by the impact of FDI on US military and critical technology advantages, cyber capabilities, intellectual property, and supply chain integrity – equities generally managed by the Departments of Defense, Justice (to include the Federal Bureau of Investigation) and Homeland Security
 - From 2000 through 2017, national security agencies embraced commercial technologies outside of the Government R&D or procurement process as a way to cut costs and take advantage of cutting edge technologies developed by the private sector

National Security Related Transactions

- CFIUS reviews transactions that could impact US National Security or Critical Infrastructure
 - CFIUS interprets these terms broadly
- CFIUS looks at all of the facts and circumstances:
 - Nature of the US business
 - Identity of the foreign investor
 - Foreign government control
 - Country of foreign investor
 - Factors that may not be apparent to the parties
- Areas of recent, heightened interest where parties appear to have been caught by surprise
 - Big data
 - Semiconductors (all aspects of the industry)
 - Financial services

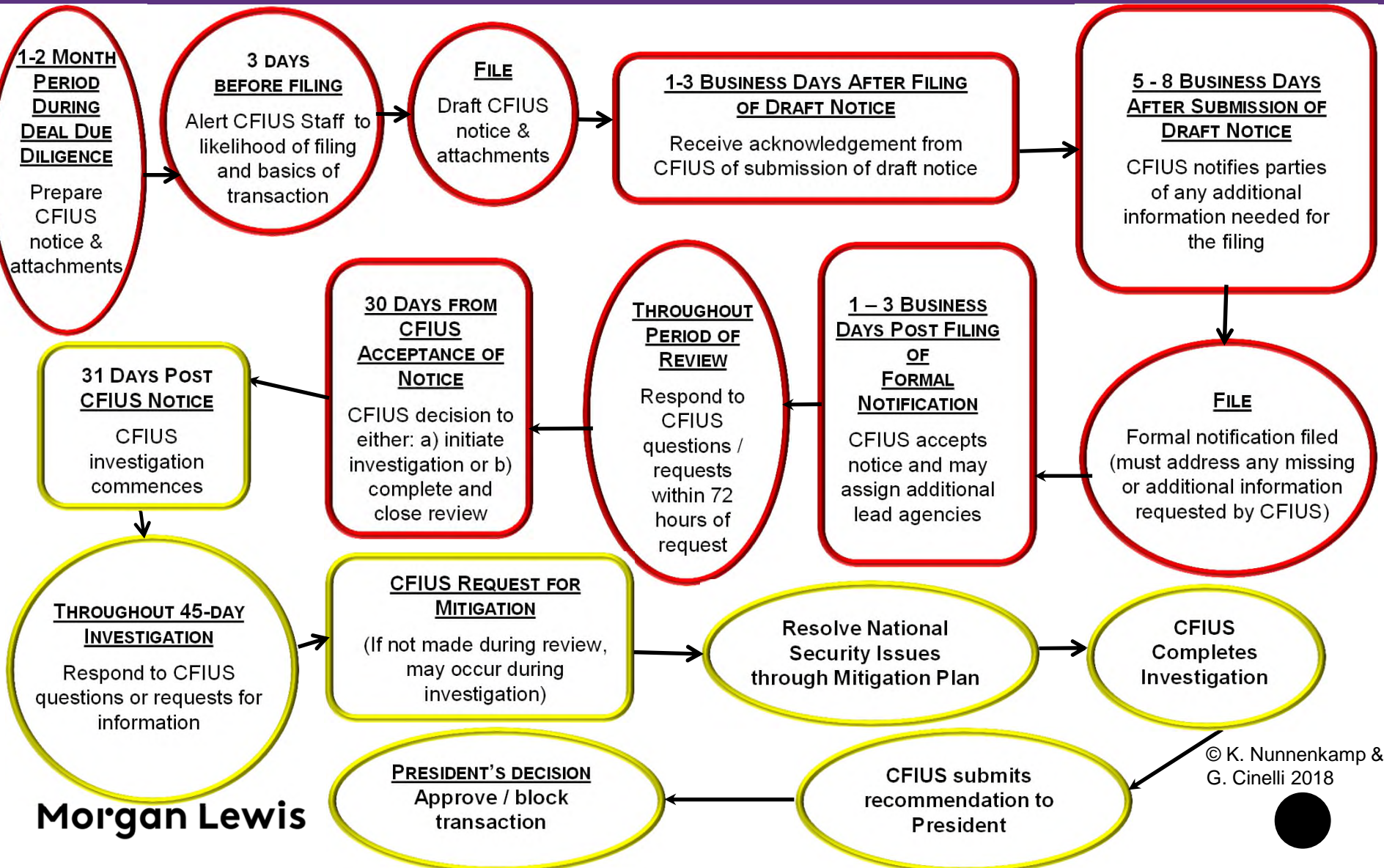
National Security Related Transactions

- CFIUS considers both the Buyer and the Seller carefully
 - US Businesses that often raise CFIUS concerns
 - provide products/services to US Government – especially agencies with national security functions
 - provides products/services that could expose national security vulnerabilities
 - critical infrastructure
 - access to classified information
 - defense, security, national-security law enforcement sectors
 - advanced technology
 - Physical locations close to secure US Government facilities, i.e. military installations
 - Technology, goods, or software subject to US export controls
 - Defense or other critical US Government supply chain presence
 - These may not always be readily apparent (i.e., hidden in place)

National Security Related Transactions

- Increased focus on Cybersecurity Risks
 - Actual or potential cybersecurity threats to national security or critical infrastructure
 - Cyber issues can arise in a variety of transactions
 - The acquisition of infrastructure assets connected to integrated utility systems (e.g., electrical grids, natural gas transmission lines)
 - In the wrong hands
 - Will the foreign owner adequately protect those assets
 - Foreign owner's amenability to cooperation with the US Government
 - The introduction of "back doors" or other malicious code into US computer and telecommunications systems
- National security is as much about tomorrow as today

CFIUS Timeline



Clearing CFIUS

- Preparation makes a difference
- The increased CFIUS workload (submissions have more than doubled since 2015, but staffing remains constant)
- Incomplete CFIUS submissions take longer
- “Reviews” are extended when parties withhold information
- Increased Chinese involvement and increased deal creativity slow down the reviews
 - Chinese focus on critical technologies, i.e., semiconductors, AI
 - Creative transaction structures
 - Increased activity by PE and similar, often complex vehicles
- Increase in mitigation agreements designed to limit the national security impact

Clearing CFIUS

- Recent transactions that further underscored the Government's focus on the national security implications of cross-border investments:
 - 2016:
 - Philips NV's proposed sale of Lumileds to a Chinese Consortium (including GSR Ventures and Nanchang Industrial Group) (January 2016)
 - Fairchild Semiconductor International proposed sale to China Resources Microelectronics Ltd and Hua Capital Management Co Ltd. (February 2016)
 - AIXTRON SE proposed sale to Grand Chip Investment GmbH (a Chinese company) (December 2016)
 - 2017:
 - Wolfspeed proposed sale to Infineon Technologies (February 2017)
 - Inseego Corporation proposed sale of MiFi business to TCL Industries Holdings (June 2017)
 - Global Eagle Entertainment, Inc. proposed sale to HNA Co Ltd (July 2017)
 - 2018:
 - Moneygram proposed sale to Ant Financial (January 2018)
 - Genworth pending sale to China Oceanwide (multiple withdrawals)

Clearing CFIUS

- ❖ Factors impacting the length of the CFIUS review process
 - ❖ Parties submitting incomplete draft notices more frequently
 - ❖ Lack of transparency leading to increased requests for information, both prior to formal submission and during the formal filing process
 - ❖ Minimalist filings, combined with CFIUS staffing issues can increase the time needed to complete the pre-filing review
 - ❖ More mitigation agreements or other transaction changes to address national security or critical infrastructure concerns
 - ❖ Need to address the shifting priorities of national security
 - ❖ This all led to an increased number of transactions that required a 75 calendar day review period (30-day review plus 45-day investigation timeline)

Clearing CFIUS

- ❖ Heightened Congressional interest in modernizing the CFIUS process
 - ❖ Increased and new areas of concern resulting from a developing understanding of geopolitical and regional national security threats
 - ❖ Big data
 - ❖ Personal information
 - ❖ Access to technology and R&D that can be used to leapfrog existing US capabilities
 - ❖ Cyber, software, artificial intelligence
- ❖ On the horizon
 - ❖ Supply chain (always there, but expect increased focus, especially on cross-over COTS)
 - ❖ Food and biotechnology
 - ❖ Robotics

Pending CFIUS Legislation

Draft Bill Number	Title	Sponsors	Date	Summary
S. 1722	True Reciprocity Investment Act of 2017	Sullivan	August 20, 2017	Requires a report from the US Trade Representative, in consultation with the Department of Commerce, to determine whether countries provide investment reciprocity to US investors
S. 1983	United States Foreign Investment Review Act of 2017	Brown and Grassley	October 20, 2017	Establishes a mandatory process at the Department of Commerce to review cross-border transactions in relation to reciprocal treatment by a foreign purchaser's home country; designed to supplement, not replace, the voluntary CFIUS process
S. 2098*	Foreign Investment Risk Review Modernization Act of 2017	Cornyn, Feinstein, Burr, Peters, Rubio, Klobucher, Scott, Barrasso, Manchin, Lankford, and Collins	November 17, 2017	Enhances and expands CFIUS' authorities to review additional transactions, joint ventures, cross-border investments related to a range of technologies; defines "countries of concern"; sets a fee for a voluntary CFIUS filing; establishes new factors to consider when assessing the national security implications of a cross-border investment; establishes a "CFIUS lite" process

Pending CFIUS Legislation

Draft Bill Number	Title	Sponsors	Date	Summary
HR 4235	To authorize a review of financial services industry requirements of the People's Republic of China and the implications of such requirements on national security interests of the United States	Smith, Estes, Jenkins, Franks	December 3, 2017	Establishes factors to consider in financial services transactions that involve China; identifies areas of concern regarding such transactions
HR 4337	Safeguarding American PII Act	Royce and Maloney	January 7, 2018	Requires consideration of access (or potential access) to personal information as part of a CFIUS review to assess national security implications of cross-border investments
HR 4311*	Foreign Investment Risk Review Modernization Act of 2017	Pittenger, Nunes, Smith, Hartzler, Yoho, Rogers, DeLauro, Gallagher, Roby, Loesbeck, Heck, Weber, Johnson, Culberson, Duffy, King, Stefanik, Banks, DeSantis, and Graves	January 7, 2018	Companion bill Act to S. 2098

Clearing Transactions with CFIUS

A New Paradigm

- ❖ Anticipated legislative changes
- ❖ Increased scrutiny of specific transactions involving:
 - ❖ Specific countries will come under mandatory increased scrutiny – China, Russia, proxy countries
 - ❖ A broader range of technologies and/or services will be more carefully assessed
 - ❖ Foundational or disruptive technologies – whether civil or defense related
 - ❖ Big data and data management
 - ❖ Companies or businesses that may be crucial to the supply chain for US national security or critical infrastructure interests
 - ❖ AI, robotics, autonomous vehicles (air, underwater, ground)

Clearing Transactions with CFIUS Transaction/Expectation Management

- ❖ Additional factors to consider
 - ❖ Foreign purchaser's history of compliance with US laws and regulations
 - ❖ Protection of personal information
 - ❖ Role in the supply chain
 - ❖ Transaction financing
 - ❖ Candor and accuracy
 - ❖ Consistent representations
 - ❖ Indirect foreign government control or influence

Clearing Transactions with CFIUS Transaction/Expectation Management

- ❖ Preparing for the changes
 - ❖ Expand your due diligence – *e.g.*, not only of the business but of the parties involved
 - ❖ Research beyond the information provided by the parties – *see, e.g., Ness Technologies SARL v. Pactera Technology International, et al.* (Supreme Court of NY, Filed December 6, 2016)
 - ❖ Plan for detailed filings – *e.g.*, parties will likely find little success by taking the approach that “we’ll submit it to CFIUS and see what it says”
 - ❖ Carefully consider financial penalties when CFIUS is a closing condition
 - ❖ Answer CFIUS questions asked, not ones the parties would like to answer
 - ❖ Although the process remains voluntary, the Government has identified and is using resources to educate itself on transactions that have occurred or are underway, but have not been notified to the Committee

QUESTIONS?

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Giovanna M. Cinelli is co-lead of the International Trade, National Security and Economic Sanctions practice. As a practitioner for more than 25 years, she counsels clients in the defense and high-technology sectors on a broad range of issues affecting national security and export controls, including complex export compliance matters, audits, cross-border due diligence, and export enforcement, both classified and unclassified. She handles complex civil and criminal export-related investigations and advises on transactional due diligence for regulatory requirements involving government contracts, export policy, and compliance, as well as settlement of export enforcement actions before the US departments of State, Commerce, Treasury, and Defense, and related agencies. Giovanna has conducted dozens of export investigations and has negotiated six consent agreements before the Department of State. She advises clients on matters before the Committee of Foreign Investment in the United States (CFIUS), and addresses mitigation requirements that may apply as part of CFIUS clearances for cross-border transactions.

Biography



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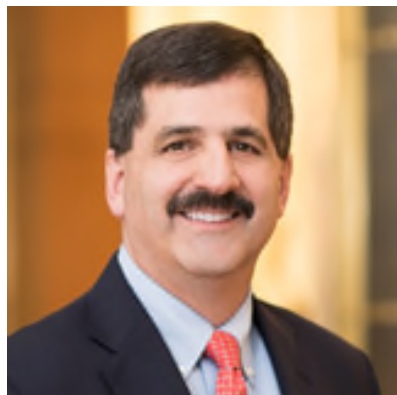
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Margaret Gatti represents US and non-US companies, universities, and financial institutions in matters involving economic sanctions, export controls under the International Traffic in Arms Regulations (ITAR) and the Export Administration Regulations (EAR), customs and import regulations, free trade agreements, antiboycott regulations (EAR and IRS), anticorruption laws (FCPA and UKBA), anti-money laundering legislation, international commercial sales terms (INCOTERMS), international e-commerce, and Bureau of Economic Analysis (BEA) reporting, as well as national security issues.

As part of her export control and national security practices, Ms. Gatti also is involved in filings before the Committee on Foreign Investment in the United States (CFIUS), and has represented both foreign buyers and investors in and domestic sellers of U.S. businesses in reviews by that Agency. She has substantial experience in negotiating and mitigating Foreign Ownership, Control, and Influence (FOCI) issues that may be presented as conditions to clearance of a proposed transaction.

She also advises on internal investigations, enforcement cases, and dispute resolution proceedings relating to her transactional and regulatory practice.

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Carl Valenstein focuses his practice on domestic and international corporate and securities matters, mergers and acquisitions, project development, and transactional finance. He counsels extensively in the life science, telecom/electronics, and maritime industries, and he has worked broadly in Latin America, the Caribbean, Europe, Africa, Asia and the Middle East.

Carl advises clients on international risk management, including compliance with the foreign investment review process (Exon-Florio/CFIUS), export control and sanctions, anti-money laundering, anti-boycott, and anticorruption (FCPA) laws and regulations. He also advises on internal investigations, enforcement cases, and dispute resolution proceedings relating to his transactional and regulatory practice.

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