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TECHNOLOGY MAY-RATHON: CFIUS'S IMPACT ON TECHNOLOGY TRANSACTIONS

FIRRMA Now and Going Forward
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The New CFIUS

- Committee on Foreign Investment in the United States (“CFIUS” or “the Committee”) reviews cross-border investments in the US
- CFIUS conducts its reviews pursuant to factors designed to highlight and address US national security and critical infrastructure concerns
- Although CFIUS is a US process, other countries – *e.g.*, Canada, Japan, Germany, France, Australia, the UK (in development) and the EU (in development)
- Recent legislative and regulatory changes have expanded the Committee’s focus and affected the transactions, industries, and technologies subject to CFIUS’ review and jurisdiction
- This shift impacts the information due diligence process and whether and when to file a CFIUS notice

The New CFIUS

- Generally, CFIUS reviews 'covered transactions' – whether mergers, acquisitions or takeovers – by a foreign person that result in control of a US business
- On October 11, 2018, the Department of Treasury, the chair of CFIUS, issued interim regulations that expanded the Committee's jurisdiction to non-controlling investments in US businesses that are involved with critical technologies
 - Done through a pilot program
 - Effective November 10, 2018
 - Established specific definitions for the pilot program
 - Established a mandatory declaration process that added a required filing, not just voluntary filings
 - Identified industries subject to the mandatory process

The New CFIUS

- Key areas to address: Implemented through a pilot program
 - “Controlling” versus “passive” investments
 - The definition of “Pilot Program US business”
 - The definition of “Pilot Program critical technologies”
 - The definition of “Pilot Program covered transaction”
 - Additional factors to identify the definitions noted above
 - Filing deadlines
 - Manner in which transactions are structured
 - Considerations to limit potential allegations of transaction structures designed to ‘avoid’ or ‘evade’ CFIUS review

The New CFIUS

- Practical effect – New Transactions Subject to Review
- Documents to review
 - NAICS codes – the regulations define ‘critical technologies’ industry sectors by primary NAICS codes
 - Export classifications – cover EAR, ITAR, NNSA, NRC, DOE, viruses/toxins and “emerging or foundational technologies”
 - US and foreign government engagements
 - Direct
 - Indirect
 - R&D
 - Commercial-off-the-shelf purchases
 - Government directed export activities

The New CFIUS

➤ Structuring Transactions

- Analyzing transactions to determine whether a mandatory filing is required
- Analysis is needed at the front end of the transaction – at the time the investment is contemplated, not at the document drafting stage
- Transactions are structured to address business and regulatory requirements – *e.g.*, revenue streams, customer requirements, tax benefits, IP issues – but how will this be interpreted in light of the “avoidance” of CFIUS review factor?
- Recasting a transaction is not uncommon but consideration needs to be given to potential CFIUS review when changing transaction structures, if the changes are designed to:
 - Evade CFIUS review or
 - Avoid CFIUS review

FOREIGN INVESTMENT RISK REVIEW MODERNIZATION ACT OF 2018 (FIRRMA)

- What has generally changed
 - What is included in the “covered transactions” definition (§ 1703(a)(4))
 - What is exempt from CFIUS review and/or “covered transactions” definition
 - Identifying critical technologies of interest (ECRA § 1758)
 - Mitigation agreements
 - Time periods for reviews
 - Filing fees (§ 1723(p)(3)(B))
 - Effective dates (§ 1727)

FIRRMA'S IMPACT

- FIRRMA resulted in three types of changes to CFIUS jurisdiction
 - FIRRMA codified and formalized certain existing practices and CFIUS jurisdiction
 - FIRRMA narrowed CFIUS' jurisdiction in several areas
 - FIRRMA expanded CFIUS' jurisdiction regarding certain types of transactions

FIRRMMA

- Key elements of CFIUS reviews under FIRRMMA
 - Covered transactions
 - Control or ownership
 - Critical infrastructure
 - Critical technologies
 - Foreign parties
 - National security concerns
 - US business
 - Mitigation (interim and final)
 - Filing fees
 - Timelines
 - US citizen sensitive personal information/“big data”

- **New Considerations for Foreign Investors in High Tech**
- A non-controlling investment can trigger the pilot program analysis if any of the following rights has been granted:
 - Access to any material nonpublic technical information in the possession of the pilot program U.S. business;
 - Membership or observer rights on the board of directors or equivalent governing body of the pilot program U.S. business or the right to nominate an individual to a position on the board of directors or equivalent governing body of the pilot program U.S. business;
 - Any involvement, other than through voting of shares, in substantive decision making of the pilot program U.S. business regarding the use, development, acquisition, or release of critical technology.

- **New Considerations for Foreign Investors in High Tech**
- The Pilot Program regulations also address “investment fund investments” and provide that “indirect investments” by a foreign fund in a US business via another fund do not constitute covered transactions even if the indirect investment allows for an advisory board seat (also using the term “committee of the fund”) if specific terms apply to the investment

FIRMA

- **New Considerations for Foreign Investors in High Tech**

- The fund is managed exclusively by a general partner, a managing member, or an equivalent
- The foreign person is not the general partner, managing member, or equivalent
- The advisory board or committee does not have the ability to approve, disapprove, or otherwise control
 - Investment decisions of the investment fund; or
 - Decisions made by the general partner, managing member, or equivalent related to entities in which the investment fund is invested
- The foreign person does not otherwise have the ability to control the investment fund, including the authority:
 - To approve, disapprove, or otherwise control investment decisions of the investment fund;
 - To approve, disapprove, or otherwise control decisions made by the general partner, managing member, or equivalent related to entities in which the investment fund is invested; or
 - To unilaterally dismiss, prevent the dismissal of, select, or determine the compensation of the general partner, managing member, or equivalent;
- The foreign person does not have access to material nonpublic technical information as a result of its participation on the advisory board or committee

- **New Considerations for Foreign Investors in High Tech**

- Although the ultimate regulations will likely mirror this (and add some more factors in the legislation), at the moment, the key provisions of non-Pilot Program regulations relate to control. The current CFIUS regulations would require that a fund have “control” as defined in the CFIUS regulations for an otherwise US fund to be considered foreign. (Emphasizing here, again, that ours is an analogy, not something that actually is addressed by the regulations)

- **New Considerations for Foreign Investors in High Tech**

- When considering control, CFIUS provides guidance, which can be divided into two categories—one which addresses factors showing control and the other which addresses “questions of control in situations where more than one foreign person has an ownership interest in an entity.”
- CFIUS provides the following definition and factors that are indicia of control:
- The term control means the power, direct or indirect, whether or not exercised, through the ownership of a majority or a dominant minority of the total outstanding voting interest in an entity, board representation, proxy voting, a special share, contractual arrangements, formal or informal arrangements to act in concert, or other means, to determine, direct, or decide important matters affecting an entity.

FIRMA

- **New Considerations for Foreign Investors in High Tech**

- CFIUS defines “important matters” as “the ability to determine, direct, take, reach, or cause decisions regarding the following matters, or any other similarly important matters affecting an entity”

- **Examples of Important Matters Defined**

- The sale, lease, mortgage, pledge, or other transfer of any of the tangible or intangible principal assets of the entity, whether or not in the ordinary course of business;
- The reorganization, merger, or dissolution of the entity
- The closing, relocation, or substantial alteration of the production, operational, or research and development facilities of the entity
- Major expenditures or investments, issuances of equity or debt, or dividend payments by the entity, or approval of the operating budget of the entity
- The selection of new business lines or ventures that the entity will pursue
- The entry into, termination, or non-fulfillment by the entity of significant contracts
- The policies or procedures of the entity governing the treatment of non- public technical, financial, or other proprietary information of the entity
- The appointment or dismissal of officers or senior managers
- The appointment or dismissal of employees with access to sensitive technology or classified U.S. Government information
- The amendment of the Articles of Incorporation, constituent agreement, or other organizational documents of the entity with respect to the matters described in (a) through (i)

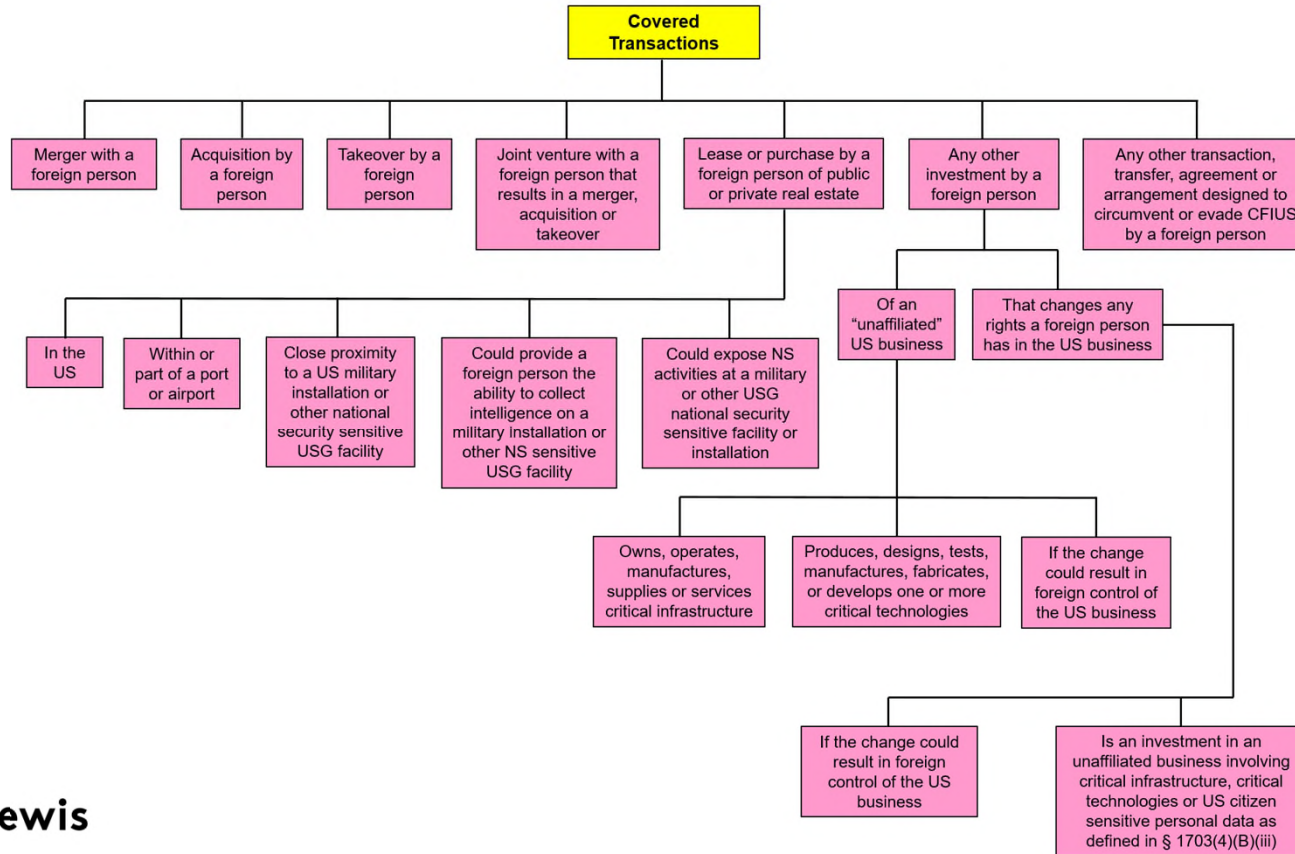
FIRRTMA

- **New Considerations for Foreign Investors in High Tech**
- For situations where there is more than one foreign owner, consideration will be given to factors such as:
 - whether the foreign persons are related or have formal or informal arrangements to act in concert
 - whether they are agencies or instrumentalities of the national or subnational governments of a single foreign state, and
 - whether a given foreign person and another person that has an ownership interest in the entity are both controlled by any of the national or subnational governments of a single foreign state.

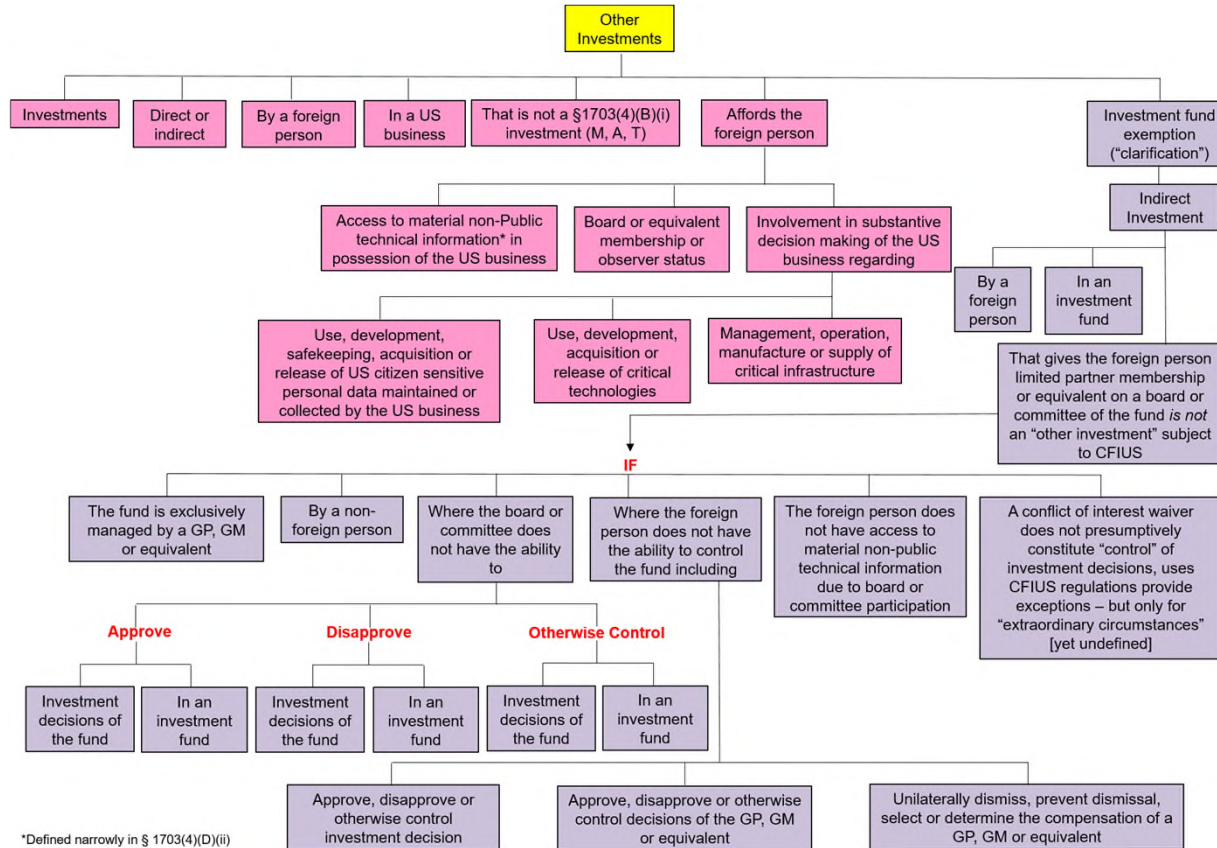
FIRMA

- **New Considerations for Foreign Investors in High Tech**
- **The regulations also provide that certain minority shareholder protections shall not in themselves be deemed to confer control over an entity:**
 - The power to prevent the sale or pledge of all or substantially all of the assets of an entity or a voluntary filing for bankruptcy or liquidation
 - The power to prevent an entity from entering into contracts with majority investors or their affiliates
 - The power to prevent an entity from guaranteeing the obligations of majority investors or their affiliates
 - The power to purchase an additional interest in an entity to prevent the dilution of an investor's pro rata interest in that entity in the event that the entity issues additional instruments conveying interests in the entity
 - The power to prevent the change of existing legal rights or preferences of the particular class of stock held by minority investors, as provided in the relevant corporate documents governing such shares; and
 - The power to prevent the amendment of the Articles of Incorporation, constituent agreement, or other organizational documents of an entity with respect to the matters described above.

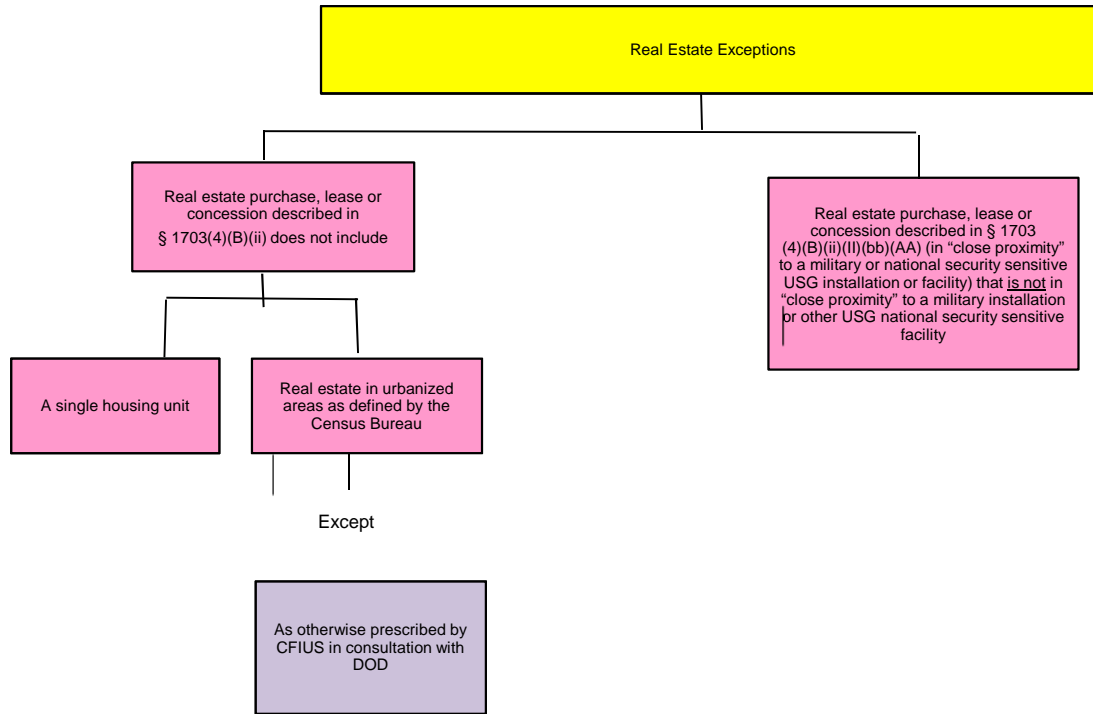
FIRRTMA § 1703(4)(A) and (B)



FIRMA § 1703(4)(D)



*Defined narrowly in § 1703(4)(D)(ii)



LEGAL FRAMEWORK

FIRRMA EFFECTIVE DATES

Effective Date	FIRRMA §	FIRRMA Language
August 13, 2018	1703 (a)(1), (2), (3), (4)(A)(i), (4)(B)(i), (4)(B)(iv)(I), (4)(B)(v), (4)(C)(v), (5) to (13)	Definitions
	1705	Inclusion of partnership and side agreements
	1707	Stipulations regarding transactions
	1708	Unilateral initial reviews
	1709	Timing for reviews
	1710	Identification of non-notified and non-declared transactions
	1712 (except for 721 (b)(4)(A))	DNI Analysis
	1713	Information Sharing (public disclosure and sharing with Allies)
	1714	Action by the President
	1715	Judicial review
	1716	Consideration for regulations
	1717	CFIUS Membership & Staff (new Assistant Secretary)
	1718	CFIUS Actions to address national security risks
	1719 (except for (a)(3) [(ii)-(v)])	Annual reports and other reports (e.g.,) Department of Commerce reports on PRC) (Inclusion of unclassified version elements delayed)
	1720	Certifications of Notices & Information
	1721	Implementation Plans
	1722	Assessment of Additional Resources
	1723	Funding
	1724	Centralization of Certain CFIUS Functions
	1725	Conforming Amendments
	1727	Effective Date

The New CFIUS

➤ Next steps

- Treasury must draft final regulations within 18 months of August 2018
- The pilot program will be used to draft final regulations and determine what portions of the pilot programs can be implemented in final form
- Filing fees will be required - \$300,000 or 1% of the value of the transaction (whichever is less)
- A process has been established by the Export Control Reform Act of 2018 (ECRA) to identify emerging or foundational technologies - new category of 'critical technology' that is focused on technologies that have not been identified by regulations or traditionally the focus of CFIUS review

The New CFIUS

➤ **Pilot Program NAICS Code Industries**

- Aircraft Manufacturing (336411)
- Aircraft Engine and Engine Parts Manufacturing (336412)
- Alumina Refining and Primary Aluminum Manufacturing (331313)
- Ball and Roller Bearing Manufacturing (332991)
- Computer Storage Device Manufacturing (334112)
- Electronic Computer Manufacturing (334111)
- Guided Missile and Space Vehicle Manufacturing (336414)
- Guided Missile and Space Vehicle Propulsion Unit and Propulsion Unit Parts Manufacturing (336415)
- Military Armored Vehicle, Tank and Tank Component Manufacturing (336992)
- Nuclear Electric Power Generation (221113)
- Optical Instrument and Lens Manufacturing (33314)
- Other Basic Inorganic Chemical Manufacturing (325110)
- Other Guided Missile and Space Vehicle Parts and Auxiliary Equipment Manufacturing (336419)
- Petrochemical Manufacturing (325110)
- Powder Metallurgy Part Manufacturing (332117)
- Power, Distribution and Specialty Transformer Manufacturing (335311)

The New CFIUS

➤ **Pilot Program NAICS Code Industries**

- Primary Battery Manufacturing (335912)
- Radio and Television Broadcasting and Wireless Communications Equipment Manufacturing (334220)
- Research and Development in Nanotechnology (541713)
- Research and Development in Biotechnology (except Nanobiotechnology) (541714)
- Secondary Smelting and Alloying of Aluminum (331314)
- Search, Detection, Navigation, Guidance, Aeronautical, and Nautical Sys. and Inst. Mfg (3354511)
- Semiconductor and Related device Manufacturing (334413)
- Semiconductor Machinery Manufacturing (333242)
- Storage Battery Manufacturing (335911)
- Telephone Apparatus Manufacturing (334210)
- Turbine and Turbine Generator Set Units Manufacturing (333611)

QUESTIONS?

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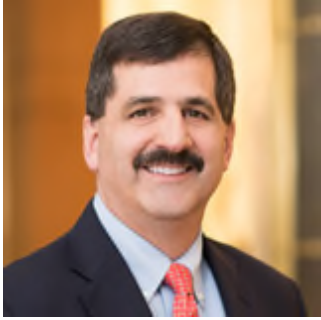
A full listing and of our tech May-rathon programs can be found at

<https://www.morganlewis.com/topics/technology-may-rathon>

Please be sure to tweet **#TechMayRathon**

Thank you.

Biography



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Kenneth J. Nunnenkamp represents buyers and sellers in transactions before the Committee on Foreign Investments in the United States (CFIUS), and counsels parties to transactions regarding CFIUS risks, applicability and solutions. His experience includes representation of buyers and sellers in public and private transactions in all value ranges, from small transactions in the millions to large matters in the billions, public and private. Ken's experience with CFIUS includes almost every industry and transactions involving entities from more than 35 countries, including Japan, China, Germany, the United Kingdom, Canada, Switzerland, Norway, Sweden, Indonesia, Australia, South Korea, Luxembourg, France, and many more. Ken chairs the Morgan Lewis CFIUS Working Group, which brings together the Firm's attorneys who practice in the area and who are interested in its developments. Ken's expertise encompasses trade and regulatory fields dealing with or implicating national security issues, including: US economic sanctions; Trade remedies (§§ 201, 232 and 301, and related matters, including exclusion requests, hearing testimony and Congressional involvement); Export controls and compliance/investigations under the ITAR, EAR and other regulations; US Customs regulations governing imports and exports; Customs and Census issues arising under the Foreign Trade Regulations, Endangered Species Act and Lacey Act issues with imports and exports of exotic and controlled items; C-TPAT; and Trade Agreements/Buy American issues. Ken also represents clients in matters relating to classified activities and before the Justice Department's Foreign Agent Registration Act (FARA) division. He brings more than 30 years of litigation and investigation experience, including time as a JAG Officer in the US Marine Corps. As an experienced entrepreneur, Ken applies business acumen to legal solutions, while assessing risk in user-friendly terms. He serves on the Wake Forest University Business School Board of Visitors, and publishes and presents frequently on topics relating to national security law, trade and business.

Biography



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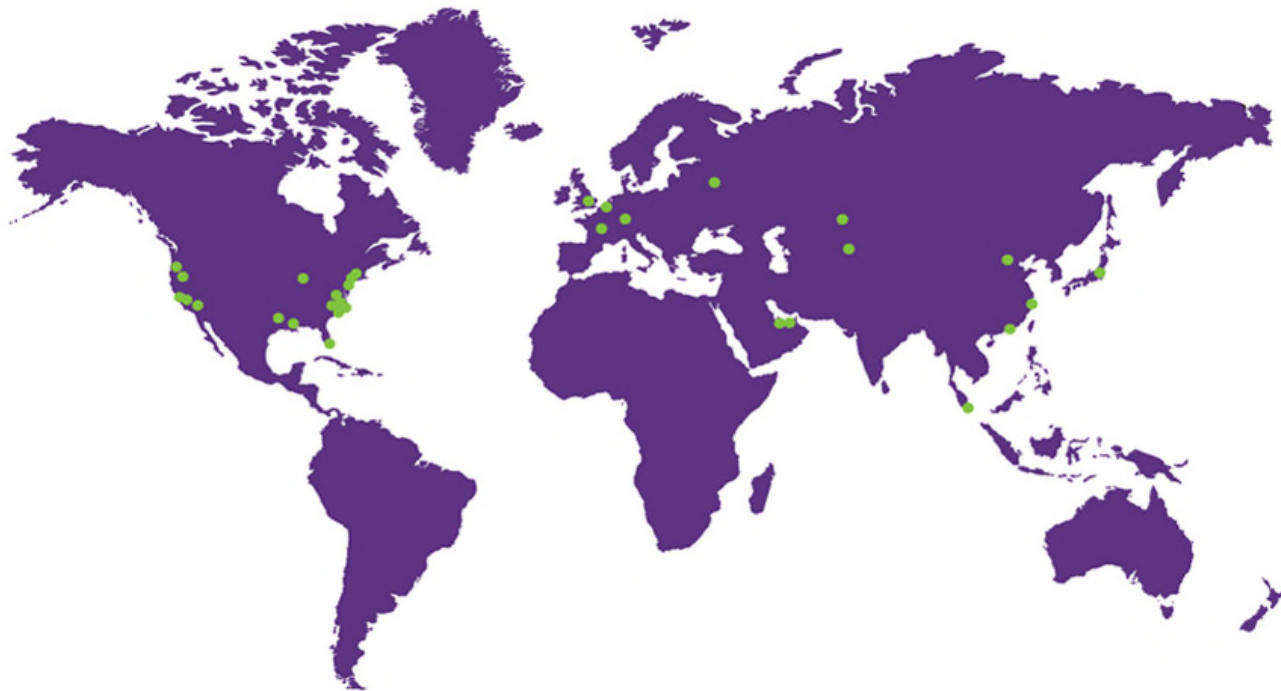
Giovanna M. Cinelli is the Firm's leader of the International Trade and National Security Practice. Throughout a career spanning over 30 years, she has represented and counseled defense, aerospace and high technology companies on a broad range of issues affecting national security, including export investigations (civil and criminal), due diligence, post-transaction cross-border compliance, Committee on Foreign Investment in the United States (CFIUS) reviews, government contracts, export policy, and licensing. She has conducted over 250 civil and criminal investigations (both unclassified and classified), addressed transactional due diligence matters in hundreds of investments, and counseled clients through the complexities of export control changes from 1992 through the present. She has negotiated complicated export enforcement settlements with the Department of State and successfully closed (without penalties) a range of directed and voluntary disclosures before the Departments of Commerce and Treasury (Office of Foreign Assets Control), as well as the Department of State.

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