

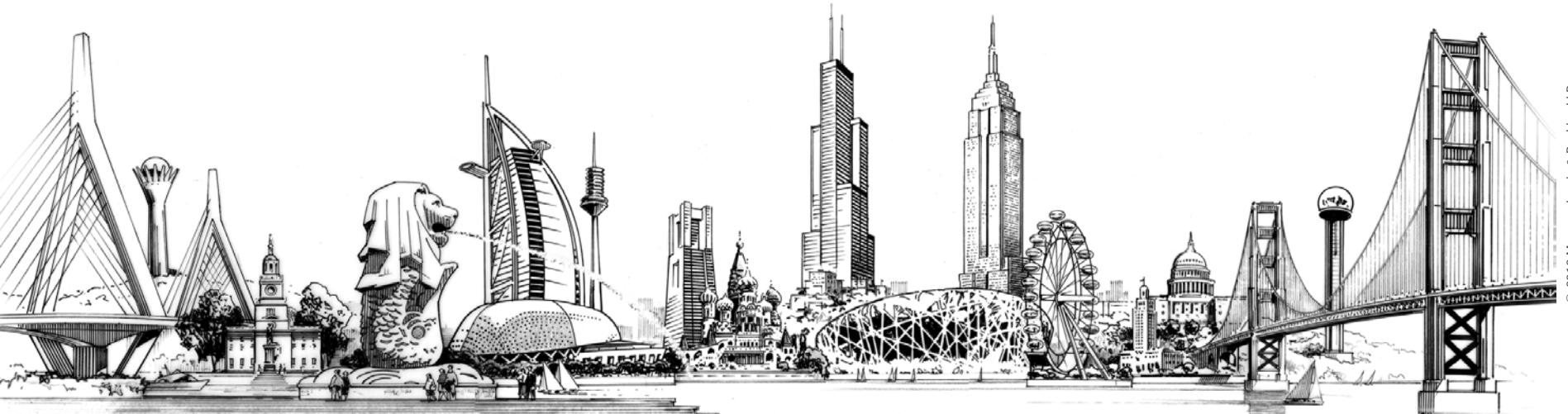
**Morgan Lewis**

# THE NEW “SLUGFEST” OVER FOREIGN DIRECT INVESTMENT IN THE US AND NATIONAL SECURITY

## HOW THE NEW CFIUS LAW (AND PILOT PROGRAM) WILL AFFECT CROSS-BORDER INVESTMENTS

Kenneth J. Nunnenkamp and Andrew J. Gray IV

November 1, 2018



# The New “Slugfest”

- 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 that address US national security and critical infrastructure concerns (now includes emerging technologies)
- Although CFIUS developed as a US process, other countries are developing or have maintained national security reviews
  - Canada, Japan, Germany, France, Australia, the UK and the EU
- Recent legislative and regulatory changes have expanded the Committee’s focus and affected the transactions, industries, and technologies subject to CFIUS jurisdiction

# The New “Slugfest”

- These changes impact transactions in a number of ways
  - Whether and when to file a voluntary CFIUS notice
  - Whether the transaction will require a mandatory declaration
  - Early strategic considerations
  - Deal terms
  - Whether to include certain syndicate parties
  - Control and/or involvement questions
  - Due diligence

# The New “Slugfest”

- CFIUS reviews
  - “Covered transactions” – i.e., mergers, acquisitions or takeovers
  - By a foreign person
  - That result in “control”
  - Of a US business
  - And that *may* impact national security

# The New “Slugfest”

- 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 adds a required filing, not just voluntary filings
  - Identified industries subject to the mandatory process

# The New “Slugfest”

- Key areas to be addressed by CFIUS going forward (Pilot program open issues)
  - “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
  - Transaction structures designed to ‘avoid’ or ‘evade’ CFIUS review
  - Who is subject to the penalties and how will penalties be determined
  - How will special start-up issues be addressed

# The New “Slugfest”

- Practical effect – strategic planning must occur earlier and CFIUS diligence must be more thorough
  - Must be prepared to review/determine
    - Applicable 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

# The New “Slugfest”

- Practical effect – Earlier/deeper dive into CFIUS issues
  - Defense Priorities and Allocations designations
  - Cyber and IT protections – plans, reports on breaches, staffing
  - Suppliers – supply chain documentation (without limitation to tier level)
  - International agreements that may apply – e.g., 123 Agreements
  - Framework agreements regarding IP
  - Lists of joint ventures and other collaborative arrangements entered into by the purchaser and countries of concern or interest to the US – e.g., China, Russia, Hong Kong, Taiwan, Venezuela (and now Turkey, Saudi Arabia)



# The New “Slugfest”

- Practical effect – earlier due diligence
  - Jurisdictions where the foreign purchaser conducts business
  - Requirements within those jurisdictions that apply to the foreign purchaser’s business – *e.g.*, China’s security laws that may require access to communications and other data stored, generated or used by the foreign purchaser; similar laws in Russia
  - Lists of internal foreign purchaser committees (and their members) who address IP or trade secret matters for the purchaser
  - All terms of the investment
  - Financial arrangements, such as loans or credit facilities
  - Provenance of investors (without regard to level of investment)

# The New “Slugfest”

## ➤ Structuring Transactions

- Analyzing transactions to determine whether a mandatory filing is required
- Analysis is needed early in the transaction – at the time the investment terms are considered, 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

# The New “Slugfest”

## ➤ Next steps

- The pilot program will go through clarification, implementation and likely some refinement
  - Could be more regulations or guidance
- Treasury must draft and issue/propose final regulations by mid-Feb 2020
- Many things can be done by pilot program, though some cannot
- Lessons learned through 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 “Slugfest”

## ➤ Current 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)

# The New “Slugfest”

## ➤ Current NAICS Code Industries

- 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 “Slugfest”

## ➤ Current 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 Systems and Instrument Manufacturing (3354511)
- Semiconductor and Related device Manufacturing (334413)

# The New “Slugfest”

- Current NAICS Code Industries
  - Semiconductor Machinery Manufacturing (333242)
  - Storage Battery Manufacturing (335911)
  - Telephone Apparatus Manufacturing (334210)
  - Turbine and Turbine Generator Set Units Manufacturing (333611)

# CFIUS DUE DILIGENCE TRAINING

**QUESTIONS?**



# Biography



## **Kenneth Nunnenkamp**

Washington, D.C.

T +1.202.739.5618

F +1.202.739.3001

[kenneth.nunnenkamp@morganlewis.com](mailto:kenneth.nunnenkamp@morganlewis.com)

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



**Andrew J. Gray IV**

Silicon Valley

T +1.650.843.7575

[andrew.gray@morganlewis.com](mailto:andrew.gray@morganlewis.com)

Serving as the leader of Morgan Lewis's semiconductor practice, Andrew J. Gray IV concentrates his practice on intellectual property (IP) litigation and prosecution and on strategic IP counseling. Andrew advises both established companies and startups on computer and Internet law issues, financing and transactional matters that involve technology firms, and the sale and licensing of technology. He represents clients in patent, trademark, copyright, and trade secret cases before state and federal trial and appellate courts throughout the United States, and before the US International Trade Commission.

## Our Global Reach

Africa  
Asia Pacific  
Europe  
Latin America  
Middle East  
North America

## Our Locations

Almaty	Chicago	Houston	Orange County	Shanghai*
Astana	Dallas	London	Paris	Silicon Valley
Beijing*	Dubai	Los Angeles	Philadelphia	Singapore
Boston	Frankfurt	Miami	Pittsburgh	Tokyo
Brussels	Hartford	Moscow	Princeton	Washington, DC
Century City	Hong Kong*	New York	San Francisco	Wilmington



# Morgan Lewis

\*Our Beijing and Shanghai offices operate as representative offices of Morgan, Lewis & Bockius LLP. In Hong Kong, Morgan Lewis operates through Morgan, Lewis & Bockius, which is a separate Hong Kong general partnership registered with The Law Society of Hong Kong as a registered foreign law firm operating in Association with Luk & Partners.

# THANK YOU

© 2018 Morgan, Lewis & Bockius LLP  
© 2018 Morgan Lewis Stamford LLC  
© 2018 Morgan, Lewis & Bockius UK LLP

Morgan, Lewis & Bockius UK LLP is a limited liability partnership registered in England and Wales under number OC378797 and is a law firm authorised and regulated by the Solicitors Regulation Authority. The SRA authorisation number is 615176.

\*Our Beijing and Shanghai offices operate as a representative office of Morgan, Lewis & Bockius LLP. In Hong Kong, Morgan Lewis operates through Morgan, Lewis & Bockius, which is a separate Hong Kong general partnership registered with The Law Society of Hong Kong as a registered foreign law firm operating in association with Luk & Partners. This material is provided for your convenience and does not constitute legal advice or create an attorney-client relationship. Prior results do not guarantee similar outcomes. Attorney Advertising.

100220344