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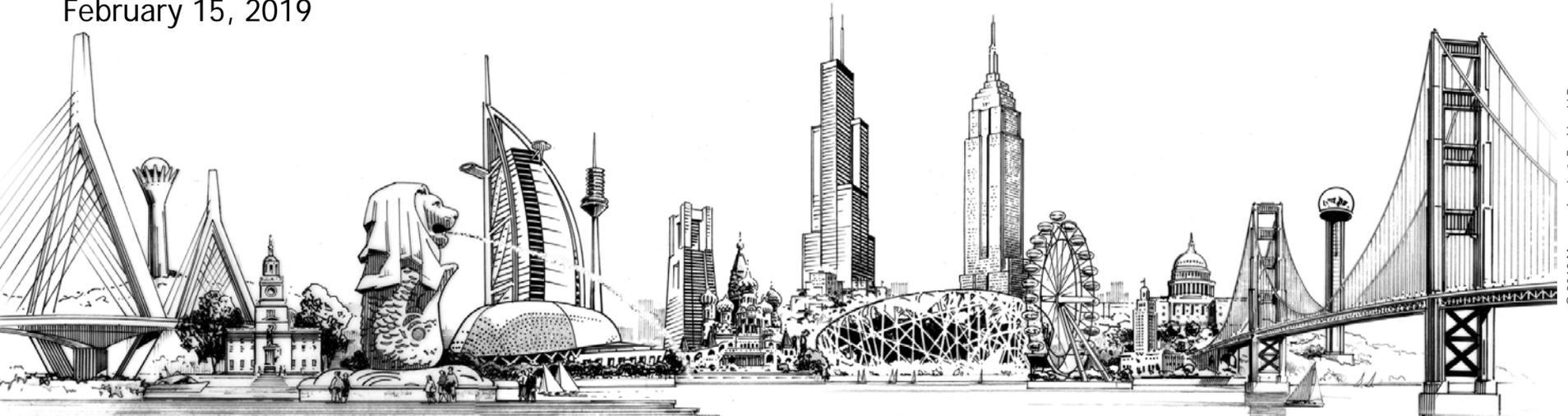
# REVIEWING CFIUS REVIEW: NATIONAL SECURITY, INDUSTRIAL POLICY, AND COMPETITION LAW

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# Current Issues: CFIUS and Competition Reviews

- Reviews under the Defense Production Act (DPA) of 1950, as amended
- FIRRTA Amendments to the DPA governing CFIUS – substantial expansion
- New Pilot Program Mandatory Filing Regulations – focus on critical technologies
- Practical consequences if a transaction is subject to the mandatory filing requirements
- Coordination of CFIUS and antitrust filings and reviews
- Coordination of remedies discussions
- Effects on timing of closing and agreement provisions
- CFIUS as an industrial policy agency

# Background on CFIUS and the Defense Production Act of 1950

- The Committee on Foreign Investment in the United States (“CFIUS”) has historically reviewed transactions involving the acquisition of control by a foreign person of a US business that pose threats to national security under the Defense Production Act of 1950.
- These reviews have historically been on a voluntary basis by parties submitting a joint filing, although CFIUS has had the right to require review of certain non-notified transactions and for the first time ever intervened before closing to block a Broadcom hostile takeover.
- Before 2016, CFIUS had blocked or forced the divestiture in only a small number of foreign investments, principally involving Chinese SOEs with military connections, and proposed mitigation terms in a slightly larger number of cases to address national security issues. The number of blocked or withdrawn transactions involving Chinese investors has increased dramatically as part of the Trump Administration’s trade war with China, but transactions are still being cleared.
- Risks are largely on foreign persons who often condition an investment on clearance by CFIUS.

# Summary of FIRRMA – Substantial Expansion of CFIUS

- On August 13, 2018, the President signed into law the Foreign Investment Risk Review Modernization Act of 2018 (“FIRRMA”).
- FIRRMA makes significant changes to both CFIUS powers and operations, particularly the assertion of jurisdiction over certain non-controlling investments involving “critical technologies.”
- FIRRMA was accompanied by the Export Control Reform Act of 2018, extending controls over licensing of certain IP, and including new coverage of “emerging and foundational technologies.”
- FIRRMA requires CFIUS to adopt implementing regulations within 18 months of enactment and authorizes CFIUS to adopt interim regulations, which CFIUS did on October 11, 2018 with the Pilot Program Regulations.

# Summary of Mandatory Pilot Program – Focus on Critical Technologies

- The Pilot Program Regulations became effective on November 10, 2018 and, in limited cases require certain transactions to be cleared with CFIUS or fines can be imposed on the parties up to the value of the transaction.
- All foreign countries are treated equally—China is not singled out.
- If a transaction constitutes a “Pilot Program Covered Transaction,” then a filing with CFIUS is required at least 45-days before the closing of the transaction.

# Summary of Mandatory Pilot Program

- The Declaration, a shortened form to be used for mandatory filings, requires extensive seller information.
- Penalty for not filing a Declaration when required is up to the value of the transaction.
- Filing a Declaration does not provide a safe harbor, unlike a Joint Voluntary Notice.
- The new mandatory feature and potential sanctions will necessitate more front-end due diligence on transactions. For the time being, filing fees are not being required but it is anticipated that fees will be introduced in the near future (as authorized per FIRRMA, to be the lower of \$300,000 or 1% of the value of the transaction).
- Even if a transaction is not a Pilot Program Covered Transaction, it may still be a “covered transaction” for purposes of CFIUS review.

# How to tell if a transaction is a Pilot Program Covered Transaction?

A “Pilot Program Covered Transaction” is defined as either:

- (a) A “pilot program covered investment” or
- (b) “any transaction by or with a foreign person that could result in foreign control of any pilot program US business, including such a transaction carried out through a joint venture”

# How to tell if a transaction is a Pilot Program Covered Transaction?

A “pilot program covered investment” is the acquisition of an equity interest (including a contingent equity interest), direct or indirect, in an unaffiliated pilot program covered business that could not result in control (i.e., non-controlling) and affords that foreign person:

- (a) access to any material non-public technical information in the possession of the pilot program US business;
- (b) membership or observer rights on the board of directors or equivalent government body of the pilot program US business or the right to nominate an individual to a position on the board of directors or equivalent governing body of the pilot program US business; or
- (c) Any involvement, other than through voting of shares, in substantive decision making of the pilot program US business regarding the use, development, acquisition or release of “critical technology.”

# How to tell if a transaction is a Pilot Program Covered Transaction?

A “pilot program US business” means any US business that produces, designs, test, manufactures or develops a “critical technology” that is:

- (a) Utilized in connection with the US business’s activity in one or more “pilot program industries”; or
- (b) Designed by the US business specifically for use in one or more “pilot program industries.”

# How to tell if a transaction is a Pilot Program Covered Transaction?

A “pilot program industry” is defined as any of the 27 industries identified in Annex A to the regulations by reference to the NAICS codes. Note that the NAICS codes are broad and prepared for statistical purposes and there is no agency charged with responsibility for a final determination if an industry is covered.

## ➤ 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)

# How to tell if a transaction is a Pilot Program Covered Transaction?

## ➤ 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)

# How to tell if a transaction is a Pilot Program Covered Transaction?

## ➤ 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 Nanotechnology) (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)

# How to tell if a transaction is a Pilot Program Covered Transaction?

## ➤ Current NAICS Code Industries

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

# How to tell if a transaction is a Pilot Program Covered Transaction?

“Critical Technologies” is defined in the Pilot Program regulations as:

- (a) technology covered by the International Traffic in Arms Regulations (ITAR);
- (b) technology covered by the Commerce Control List (CCL) of the Export Administration Regulations (EAR);
- (c) controlled nuclear related technology;
- (d) select agents or toxins; or
- (e) “emerging or foundational technologies” to be added by the Department of Commerce, under the Export Control Reform Act of 2018, which definition will also be used by CFIUS.

# How to tell if a transaction is a Pilot Program Covered Transaction?

- The Department of Commerce has issued a notice of opportunity to comment (Nov. 19, 2018) on a potential list of emerging and foundational technologies, which is very wide-ranging, including the following areas:
  - Biotechnology, including nanobiology, genomic and genetic engineering, and neurotech
  - Artificial intelligence, including neural networks, genetic programming, computer vision, expert systems, speech and audio processing, machine translation, audio and video manipulation technologies, AI cloud technologies
  - Position, navigation, and timing technology
  - Microprocessor technology, including advanced computing technology, memory-centric logic
  - Data analytics technology
  - Advanced computing technology

# How to tell if a transaction is a Pilot Program Covered Transaction?

- Quantum information and sensing technology
- Logistics technology
- Additive manufacturing (3D printing)
- Robotics, including swarming technology and molecular robotics
- Brain-computer interfaces
- Hypersonics, including flight control algorithms
- Advanced materials, including biomaterials
- Advanced surveillance technologies, including faceprint and voiceprint technologies

# Practical Consequences If Subject to Mandatory CFIUS Filing

- If your transaction is a Pilot Program Covered Transaction, you must file with CFIUS at least 45-days before the closing and be prepared for delays if CFIUS determines to conduct a complete review, which could take up to an additional 105 days of review (or more in a complex case, through re-filings).
- Need to negotiate special contractual language similar to the language used for HSR to address the risks of CFIUS review and the potential for required mitigation or blocking.
- When CFIUS filing fee is introduced, contractual language needed to allocate cost.
- May need to consider non-mandatory filing required representations in agreement.
- Even if the transaction is not a Pilot Program Covered Transaction subject to mandatory filing, the parties, particularly the foreign person should consider if it wants to condition the transaction on clearance with CFIUS if it constitutes a covered transaction under the existing regulations. The foreign person bears the risk of a required divestiture or onerous mitigation conditions, although there can be an adverse impact to share price on the US business in a partial investment transaction.

# Coordination of CFIUS Filing and Antitrust Filings and Reviews

- Need for coordination among agency filings on
  - Purpose of transaction
  - Competitors / industry competition
  - Market share statements / calculation
- Multiple potential review agencies
  - CFIUS
  - DOJ / FTC
  - FERC
  - Team Telecom (telecom acquisitions)
  - NRC

# Coordination of CFIUS Filing and Antitrust Filings and Reviews

- CFIUS and antitrust (DOJ/FTC) remedies considerably different
  - CFIUS can and often does impose monitoring responsibilities, by outside entities
  - In addition to divestiture, CFIUS can impose mitigation conditions, including
    - Prevention of foreign entity access to data, technology, or participation in decision-making of the U.S. business
    - Prevention of acquiring a board or observer seat
    - Prevention of technology transfer
- Possibility of conflicting remedies
  - DOJ/FTC requirement of divestiture, potentially with limited availability of purchasers not raising CFIUS concerns

# Effects on Timing of Closing and Agreement Provisions

- Unlike in HSR context, transaction can be closed before or during CFIUS review
- Extensions of review period or re-filing demands within sole discretion of CFIUS
- Need to consider provisions in deal agreements to address potential issues
  - Possible closing during CFIUS review
  - Whether to make a CFIUS filing only a condition or a condition precedent
  - Inclusion of break-up / reverse break-up fees
  - Contract rep that no mandatory filing is required (no “critical technology” / not a “pilot program covered transaction” / not “critical infrastructure” / target does not maintain or collect personal data of U.S. citizens)
  - Contract rep that investor is not a “foreign person”

# CFIUS as an Industry Policy Agency

- Unlike antitrust, focus on nationality of acquirer / investor
- Incorporating focus on access to personal information of U.S. citizens in investment reviews
- Willingness in at least one instance to block acquisitions that assertedly hamper U.S. national champions in technology industries
- CFIUS membership presents possible multiple avenues of contact / influence
  - Through Energy, State, Defense, Commerce, and others
- Unlike antitrust, no focus on consumer welfare standard or economic efficiency considerations in assessing transactions
  - Any evolution of antitrust away from a consumer welfare standard for evaluating competitive effects would more closely approximate CFIUS' review approach and focus
  - Focus on critical technology acquisition concerns in both CFIUS and DOJ/FTC reviews may result in reduction of investment and potential loss of competition through limitations on types or locations of foreign investors

## Biography



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Stephen Paul Mahinka is a partner in the Washington, D.C. office of Morgan, Lewis & Bockius LLP, and a member of the firm's CFIUS Working Group. Mr. Mahinka is a former leader of the firm's Antitrust Practice, founder of its FDA Practice, and co-founder and former chair of its Life Sciences Industry group. He is responsible for many of the firm's filings before the Committee on Foreign Investment in the United States (CFIUS), and has represented both foreign buyers/investors and domestic sellers of U.S. businesses in reviews, obtaining clearances for over 50 transactions in recent years, and has analyzed hundreds of proposed transactions. These CFIUS clearances obtained include transactions in the life sciences, energy (both conventional and renewable), technology, defense, and transportation industries. He has substantial experience in negotiating Foreign Ownership, Control, and Influence (FOCI) and other mitigation agreements that may be presented as conditions for clearance of a proposed transaction. Mr. Mahinka has published over 90 articles on CFIUS, FDA, and antitrust issues, and is a co-author of several books, including the ABA Antitrust Section's *Pharmaceutical Industry Antitrust Handbook* (2<sup>nd</sup> ed. 2018), *Food and Drug Law and Regulation* (3<sup>rd</sup> ed. 2015), and *Life Sciences Mergers and Acquisitions* (2008). He is a graduate of Johns Hopkins University, *Phi Beta Kappa*, and of the Harvard Law School, where he was Executive Editor of the *Harvard International Law Journal*.

## Our Global Reach

Africa  
Asia Pacific  
Europe  
Latin America  
Middle East  
North America

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