TUESDAY, SEPTEMBER 1, 2020

How to prepare for CFIUS-related questions from investors

Adelicia Cliffe and Maria Alejandra del-Cerro, partners at Crowell & Moring.

With recent changes to the CFIUS rules implementing the Foreign Investment Risk Review Modernization Act of 2018 – most significantly expanding CFIUS's authority to include certain non-controlling foreign investment and making pre-closing CFIUS filings mandatory in some circumstances – companies seeking to raise capital are likely to run into CFIUS-related questions and concerns from potential investors, whether those investors are themselves foreign, or U.S. investors that may have some level of foreign ownership.

One key to moving through the capital-raising process as smoothly and efficiently as possible is understanding whether your technology and business would be likely to fall within the regulatory purview of the Committee, and being prepared to proactively address issues that are likely to come up in the negotiation and deal structuring discussions.

WHAT TO EXPECT, AND WHY IT'S HAPPENING

In the early stages of negotiations, investors are likely to ask the companies about the nature of the company's business and technology, for the investor to determine whether CFIUS would have authority over the investment and, if so, whether a pre-closing CFIUS filing is required.

Investors generally are thinking about these issues from a process and timing standpoint as well as an overall transaction risk perspective. For example, they are trying to understand if there's any likelihood that CFIUS would block or unwind the investment, or impose mitigation measures that could change the value proposition.

The fact that the new regulations allow CFIUS to impose a penalty up to the value of the transaction for failure to notify CFIUS, where a mandatory filing is triggered, has increased the importance to both investors and targets in getting the CFIUS analysis right.

Historically, CFIUS has only had authority over transactions resulting in control of a U.S. business by a foreign person (albeit with a broad definition of "control"). In addition, notifying CFIUS of a proposed transaction in advance of closing was voluntary, though at the risk that CFIUS would be alerted to the transaction and recommend that the President block or

unwind it, or otherwise recommend some onerous mitigation measure.

With the implementation of FIRRMA, CFIUS has expanded jurisdiction over non-controlling but non-passive investments, and certain investments trigger mandatory pre-closing filings to address heightened national security concerns with certain foreign investors (i.e., those with substantial foreign government entity participation) and certain U.S. businesses (i.e., those engaged in certain activities related to critical technologies, critical infrastructure, or sensitive personal data, referred to as "TID U.S. Businesses").

While some of the CFIUS analysis may require information in the investor's hands, in terms of the nature of any foreign individuals or entities participating in the investment, as well as the specific rights – both positive and negative – that the investor will obtain, a significant part of the analysis, often dispositive for the question of jurisdiction and whether a filing is mandatory, relates to information in the target company's hands, which can be analyzed well in advance of any particular deal.

Investors may raise CFIUS questions informally in the early stages of negotiation, including CFIUS-related questions as part of diligence, and – increasingly – may include company representations related to CFIUS in the deal documents to protect against liability for getting the analysis wrong.

HOW TO PREPARE

Companies can do legwork in advance so they are prepared to respond quickly and accurately to CFIUS-related questions and to address and alleviate potential investor concerns about CFIUS risk proactively. Among the steps that companies can consider:

1. At a minimum, companies should consider doing an evaluation of whether they qualify as a "TID U.S. Business," defined to reflect three areas of particular national security concern underpinning FIRRMA and the implementing regulations:

    a. **Technology**: Is the company producing, designing, testing, manufacturing, or developing a technology that qualifies as a "critical technology" (essentially, export-controlled – see more detailed explanation below)?

    b. **Infrastructure**: Is the company engaged in certain covered functions related to listed critical infrastructure? The CFIUS regulations include a positive list of infrastructures that the Government has determined are "critical" (for purposes of assessing the risk of foreign investment), including things like certain internet protocol networks and telecommunications services, facilities manufacturing certain goods that are critical to the defense industrial base, and certain bulk power systems. For each listed critical infrastructure, the regulations also list the specific functions, the performance of which would bring the company into the scope of the "TID US Business" definition.

    c. **Data**: Does the company maintain or collect certain sensitive personal data of U.S. citizens? The regulations provide a list of ten categories of identifiable data that are considered sensitive personal data, including financial data that could be used to determine an individual's financial distress or hardship, data related to the physical, mental, or psychological health condition of the individual, and non-public electronic communications. If the data falls within one of the enumerated categories, it is considered "sensitive personal data" if it fits within one of three specific buckets (including where the company has maintained

or collected the data on greater than one million individuals at any point over the preceding 12 months).

2. Companies can also perform an export control classification analysis to determine whether their products, software, or related information qualifies as a "critical technology," one prong of the "TID U.S. Business" analysis that is particularly important and may require more time and effort than the other two prongs. The CFIUS regulations' focus on sensitive technologies reflects U.S. government concerns about the use of foreign direct investment by potential adversaries to gain a competitive edge. The chances that foreign investment will trigger a mandatory filing are significantly higher where the company is designing, developing, and/or manufacturing export-controlled technologies (and on the flip side, if the technology is not export controlled, a mandatory filing would only be triggered if there were substantial interest by a foreign government entity). Determining the export control jurisdiction and classification of the company's products and related information — meaning, identifying the export regulations that apply to the item, and the potentially applicable licensing controls – is also a prerequisite to ensuring compliance with U.S. export control laws and regulations, which also frequently arise in deal negotiations and increasingly as a required compliance representation from companies under acquisition.

3. Finally, companies can consider other national security implications. Is the company focused on or engaged in government contracting? Does the company develop cutting edge cybersecurity products? Are there other areas of focus that are likely to be of interest or concern, from a national security perspective, if the Government were alerted to the transaction?

In short, companies in growth mode can make themselves a more attractive target if they understand the CFIUS considerations, and prepare in advance of negotiations to respond quickly and accurately to questions about the business and alleviate any CFIUS concerns, whether about potential delays or overall deal risk and effect on the value proposition for the investor.

This is one area where a little of work at the front-end can save time and stress at the back-end.

ABOUT THE AUTHORS

Adelicia Cliffe is a partner at Crowell & Moring, where she is a member of the Steering Committee for the firm's Government Contracts Group; she is also a member of the International Trade Group. An expert on national security issues, government contracts and international trade, Cliffe has a particular focus on foreign investment and ownership in the United States, including reviews conducted by CFIUS, and measures to mitigate foreign ownership, control or influence. She can be reached at acliffe@crowell.com or (202) 624-2816.

Maria Alejandra del-Cerro is also a partner in the Washington, D.C. office of Crowell & Moring, and a member of the International Trade Group. Jana counsels clients with respect to U.S. export controls and economic sanctions, with a focus on technology and software transfers. She can be reached at mdel-cerro@crowell.com, or (202) 624-2843.