

## CFIUS, a national security watchdog in M&A transactions

Throughout its history, the United States has always been an advocate of free markets and has welcomed foreign investments to drive job creation and increase economic growth and productivity. Despite this open investment policy, the Committee on Foreign Investment in the United States (“CFIUS”) was created to monitor M&A transactions that could threaten its national security. CFIUS has gained increased powers over the years through new regulations in the context of the surge in cross-border M&A transactions and the rising technological threat from other countries. In this article, we will endeavor to provide a general understanding of CFIUS for foreign investors.

### What is CFIUS?

CFIUS is an inter-agency committee chaired by the Secretary of the Treasury whose members include the heads of the Departments of Justice, Homeland Security, Commerce, Defense, State, Energy and the Offices of the U.S. Trade Representative and Science & Technology Policy. It was created by President Gerald Ford in 1975

via executive order and its authority was codified into law by Congress with the Exon-Florio Amendment enacted in 1988. CFIUS was subsequently amended by the Foreign Investment and National Security Act (“FISIA”) of 2007 and more recently by the Foreign Investment Risk Review Modernization Act (“FIRRMA”) of 2018.

**Mission**

The purpose of CFIUS is to determine the impact to national security to the United States from transactions that can result in foreign ownership or control (either an individual or entity) of a U.S. business. Prior to FIRRMA, CFIUS' scope under national security was primarily limited to issues related to homeland security and critical infrastructure industries such as energy, transportation, communications, food and drug production and distribution, financial systems and natural resources. This scope was broadened with FIRRMA to include up to 27 industries (more details below).

**The key features of the review process under FINSAs**

Under FINSAs, CFIUS has authority to review "covered transactions" which encompass any transaction by or with any foreign person, which could result in foreign control of a US business. This definition is very broad, but in practice tends to be limited to equity-like investments.

The following terms need to be defined:

- A foreign person could mean a foreign national, foreign government or foreign entity. It can also include a US subsidiary of a foreign company. Indeed, what is key is to determine the nationality up the ownership chain. Note that CFIUS will have increased scrutiny on entities controlled

by foreign governments and from certain countries (such as Russia and China).

- Control is not limited to majority ownership, even minority stakes that can offer the ability to influence important matters could be considered as control. However, the "Safe Harbor" provision enables a transaction to be outside CFIUS's scope if: (i) the ownership is equal to 10% or less of the total of outstanding voting interests, and (ii) the ownership is held for passive investments.
- A US business is any entity involved in interstate commerce in the United States no matter where it is registered or headquartered. It can include a foreign company with significant US operations or assets or a joint venture involving an existing US entity.

The CFIUS review process is on a voluntary basis, meaning that even if the contemplated transaction could fall into CFIUS's scope, the parties involved do not have a legal requirement to file with CFIUS.

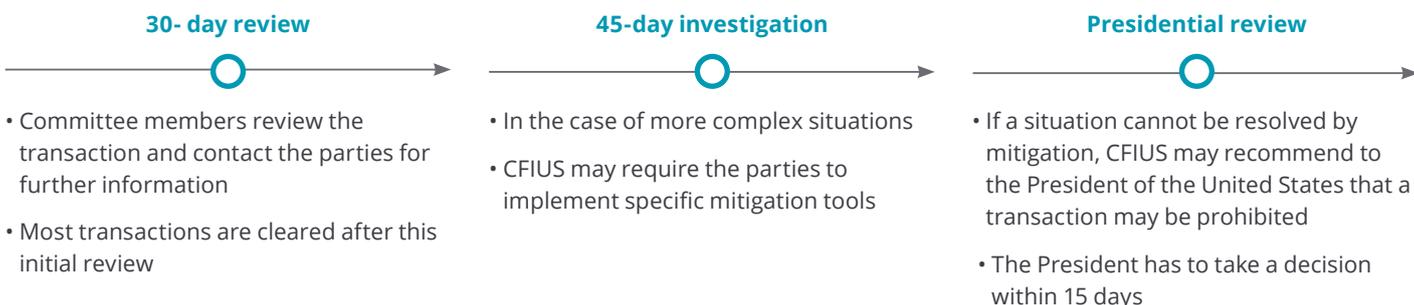
However, if CFIUS perceives that a covered transaction could potentially pose a threat to national security, it could unilaterally decide to initiate a review before or after close.

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Foreign investors should therefore weigh the pros and cons of filing with CFIUS:

Pros	Cons
Obtain clearance thus avoiding further interference	Legal fees related to filing and due diligence
	Transaction delays (see timeline below)
	\$250,000 fine if material misstatements or gross omission are present in the CFIUS filing
	Mitigation actions prescribed by CFIUS (divest part of the assets, strengthen security policies, limit the asset access to US employees)

In the case the parties involved decide to voluntarily file with CFIUS, the review process is the following:



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Throughout the review process, the parties involved provide sensitive information to CFIUS, which is subject to confidentiality requirements. The public would not know if a company files with or has been cleared by CFIUS; only the results of the Presidential reviews are disclosed to the public.

**Overview of the filing process**

Due to the complexities associated with a filing, including the strict statutory timetables once a transaction is filed, the Committee encourages the parties to consult with it in advance of filing a notice. This will both help the Committee understanding the transaction and request additional information to be included in the actual notice.

The filing documents are defined by regulations and include, but are not limited to:

- Description of the transaction;
- Detailed information of the individuals and parties to the transaction, including the financial institutions involved in the transaction;

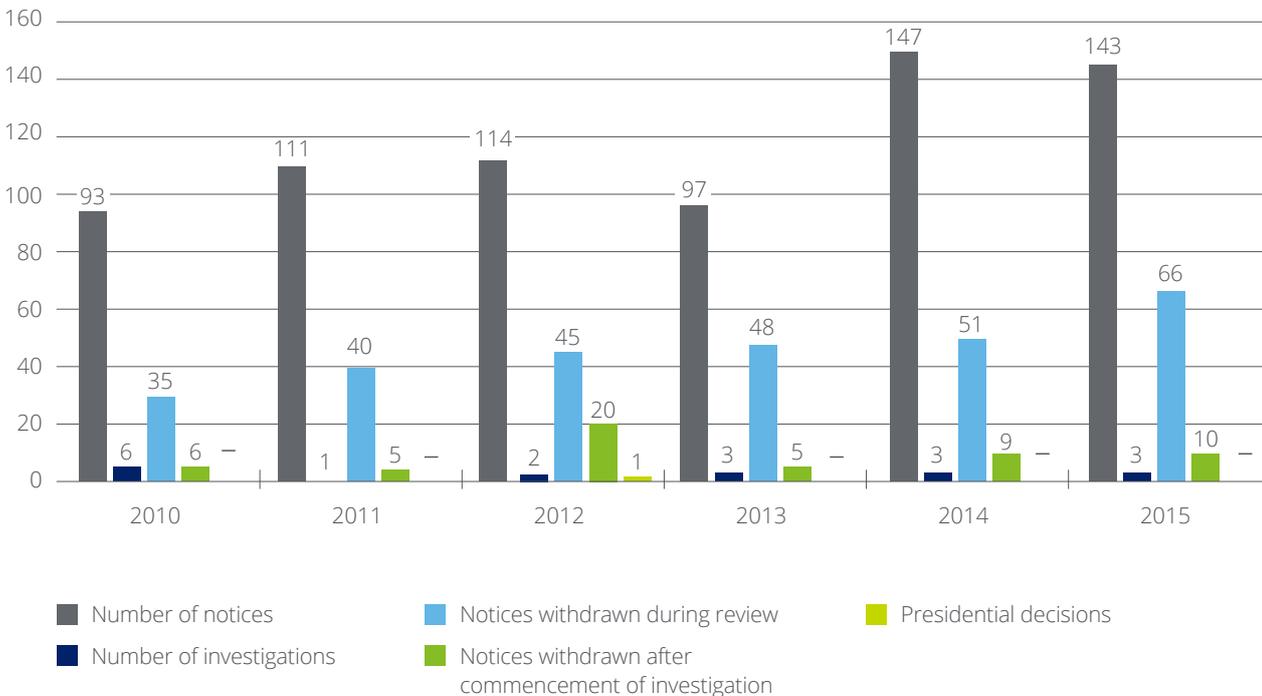
- Ownership structure and parent companies of the transaction parties and the parties' relationships to foreign governments;
- A detailed description of the assets of the U.S. business being acquired and a description of the U.S. business' operations, including locations of the U.S. business;
- Plans of the foreign acquirer with the U.S. business;
- Certain contractual or other relationships the U.S. business may have or has had with the U.S. Government; and
- Activities by the U.S. business that may have export related restrictions.

- (i) they are unable to address all the CFIUS's outstanding national concerns within the 30-day review or 45-day investigation,
- (ii) they forsake the transaction for commercial reasons, or (iii) they abandon the transaction altogether as they cannot comply with CFIUS's mitigation actions.

**Impacts on M&A transactions**

As outlined above, CFIUS powers are quite extensive, ranging from imposing reviews, restrictions or modifications on a transaction to invalidating a transaction post-close. The parties involved may re-fill their notice because of material changes or withdraw their notices if:

Below is a summary of covered transactions reviews excerpt from the 2015 Annual report to Congress (most recent data available):



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From its inception, the successive Presidents have blocked only four M&A transactions, which were perceived as a threat to national security:

Year	President	Buyer	Seller	Sector
1990	George W. Bush	China National Aero-Technology Import and Export Corporation	Mamco Manufacturing Company	Aerospace
2012	Barack Obama	Ralls Corp (US owned by Chinese nationals)	Wind farms	Located near a Navy base
2016	Barack Obama	Fujian Grand Chip Investment Fund (China)	Aixtron SE	Semiconductor
2017	Donald Trump	Canyon Bridge Capital Partners (China)	Lattice Semiconductor Corp	Semiconductor

As evidenced by recent history, the blocking of a M&A transaction by Presidents is extremely rare. Most of the time, CFIUS will work in cooperation with the parties involved to resolve potential concerns. Whenever CFIUS deems that a contemplated transaction will result in Foreign Ownership, Control or Influence ("FOCI") relating to a company that has classified information, the parties involved should enter into FOCI mitigation agreements which could be:

- Board resolutions used when the foreign entity does not own voting stock sufficient to elect a representative to the company's governing board.
- Security Control Agreements ("SCA") and Special Security Agreements (SSA) preserve the rights of foreign shareholders to be represented but limit their access to classified information.
- Proxy Agreements ("PA") and Voting Trusty Agreements ("VTA") are more restrictive. In these agreements, the foreign shareholders renounce to their ownership rights to cleared US citizens approved by the Federal Government. It thus entails the selection of proxy holders (PA) or trustees (VTA) who will serve as directors in the cleared entity.

These individuals should be "completely disinterested individuals with no prior involvement with the company, the entities with which it is affiliated, or the foreign owner" (NISPOM ¶ 2-305.b; S&S Program, attach.3, sec. 2, ch. II, at II-5.).

Besides, if a party either intentionally or through gross negligence submits a material misstatement or omission in a notice or makes a false declaration to CFIUS, it could be fined with a civil penalty of \$250,000, which could be material depending on the contemplated transaction.

### New developments with FIRRMA (2018)

President Trump ratified FIRRMA on August 13, 2018 which expands CFIUS's authority and jurisdiction. The full implementation of the legislation is expected to be effective by February 2020 to allow each party to assess the related impacts on future M&A transactions.

The key provisions of FIRRMA include:

- Broadening of the notion of "covered transactions" by adding four new types of covered transactions: (1) a purchase, lease, or concession by or to a foreign person of real estate located in proximity to sensitive government facilities; (2) "other

investments" in certain U.S. businesses other than through voting of shares; (3) any change in a foreign investor's rights resulting in foreign control of a U.S. business or an "other investment" in certain U.S. businesses; and (4) any other transaction, transfer, agreement, or arrangement designed to circumvent CFIUS jurisdiction.

- Filing fee equal to the the lower of (i) \$300,000, or (ii) 1% of the transaction value.
- Extension of the initial 30-day review to 45 days which could be extended by an additional 15 days under extraordinary circumstances.
- Implementation of a light filing or "declaration" that contain basic information regarding the contemplated transaction, which could lessen the review timelines.
- Strengthening of the use of mitigation measures and its applicability (e.g. addition of compliance plans).

### The Pilot programs

Although FIRRMA delays the applicability of its provisions until 2020, it authorized CFIUS to conduct pilot programs in certain provisions of the bill. On October 10, 2018, the first pilot program requires mandatory filing (as opposed to the initial voluntary spirit of the regulation) for controlling or non-controlling investments made by foreign investors in 27 industries producing, designing or manufacturing "critical technology". These industries include defense, computer manufacturing, semiconductors, biotechnology R&D and energy. This increased scope will enable CFIUS to have a say in sectors that contribute to the United States' technological leadership.

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### Conclusions

The dynamism in cross-border transactions and the recent developments in regulations make CFIUS an increasingly important player in M&A transactions involving a US company operating a “critical technology”. In this context, foreign investors should be aware of the CFIUS-related impacts (legal, financial and deal timing) on their contemplated transaction(s) in the United States.

In that matter, Deloitte has a strong track record of working with its clients and their counsels to support them in negotiations and implementation over the CFIUS lifecycle.

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### About the French-American desk

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