

WHAT DEAL MAKERS NEED TO KNOW ABOUT ...

AN OBSCURE COMMITTEE IN WASHINGTON THAT CAN MUCK UP YOUR DEAL

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In 1988 the United States created an inter-agency committee to advise the president about mergers and acquisitions that could pose a threat to the nation's security. It's called "CFIUS," for the Committee on Foreign Investment in the United States. Committee members include the secretaries of the Treasury, Homeland Security, Commerce, Defense, State, Energy, and Labor, and the Attorney General.¹

You need to know about this committee because it can delay your transaction, require arrangements that may affect the value of the deal, cause the transaction to be restructured, and in extreme cases cause the transaction to be blocked or unwound.

What It Covers

A transaction is subject to CFIUS review if it will result in the "control" of a U.S. business by a "foreign person." Under the regulations, control may exist without majority voting rights, based on negative covenants and other factors. The term sheet or agreement should be examined for these issues by a CFIUS specialist. If there is no foreign control of a U.S. business, no further questions need be asked.

If control exists, the question is whether the transaction could adversely affect the national security of the United States, including homeland security. Transactions that

¹ CFIUS functions under section 721 of the Defense Production Act of 1950, as amended by the Foreign Investment and National Security Act of 2007, 50 U.S.C. App. § 2170, as implemented by Exec. Ord. 11,858, as amended, and regulations at 31 C.F.R. Part 800. The director of national intelligence also sits on CFIUS but does not vote.

result in the control of critical infrastructure and critical technologies are currently in the target area for review. *Some* of the transactions that raise red flags involve:

1. Goods or services subject to export controls because they are on:
 - a. the U.S. Munitions List under the State Department’s International Traffic in Arms Regulations, known as “ITAR”; or
 - b. the Commerce Department’s Commerce Control List, known as the “CCL,” under the Export Administration Regulations;
2. U.S. government contracts of all but the most innocuous kind, but especially contracts with the departments of Defense, Energy, and Homeland Security, and any intelligence agency;
3. Critical infrastructure, such as maritime ports, airports, railways, and bridges;
4. Critical technologies, such as certain pharmaceuticals (especially vaccines and sensitive drugs), chemicals with sensitive or potential terrorist or explosives applications, and high-grade cryptology, which is usually export-controlled.

Voluntary Filing

Filing is voluntary, but if the transaction is likely to raise concerns, filing is the normal and better practice, and we advise it. And once a transaction is cleared, the government cannot later require that it be modified or unwound. Absent pre-clearance, it can do so, as happened in a transaction involving the Chinese telecommunications firm Huawei. Transactions involving Chinese and Russian companies and any enterprise controlled by a foreign state get extra scrutiny.

How It Works – Your Timetable

In a friendly transaction the parties cooperate in preparing a filing. The division of legal fees is negotiable. (For the filing itself, the principal fee determinant is whether the client is organized to produce the needed information quickly. When mitigation agreements or restructuring is involved, legal fees can rise significantly.) The time required to complete the filing varies, but you should not expect to do it in less than two weeks. Filings are often made before the parties reach a final agreement in order to minimize the

delay associated with a CFIUS review. Deals have been closed before the end of the CFIUS process, but that is unusual.

CFIUS filings are confidential and not subject to the Freedom of Information Act.

A critical issue in negotiating the transaction is whether CFIUS clearance is a condition to closing. This judgment will depend on the perceived risk that CFIUS will derail the transaction or require it to be adjusted in unacceptable ways, and appetite for the deal.

The filing triggers a 30-day review process. CFIUS will appoint one or more “lead agencies” to handle the review, depending on the nature of the technology involved. Coordination among the agencies takes time. Transactions are rarely cleared in fewer than 30 days. During the 30-day review period, the government may invoke its right to an additional 45-day investigation period. At or before the end of the review or investigation, the following things can happen:

1. CFIUS will clear the deal without conditions.
2. CFIUS will clear the deal only if the parties enter into a “mitigation agreement.” These agreements may cover the structure of the board of directors, special security procedures, the creation of a security committee of cleared U.S. persons acceptable to CFIUS, the handling of certain technology, etc. Under a “special security agreement,” independent U.S. directors monitor the behavior of the acquiring firm, or aspects of it, and foreign directors and managers may be denied access to classified or export-controlled technology.
3. In specially sensitive cases, CFIUS will clear the deal only if the parties enter into a proxy agreement by which a subsidiary of the acquiring party is organized, structured, and financed as a viable U.S. business entity independent of the foreign parent except with respect to sales of assets, bankruptcy, and certain other transactions.
4. The filing parties agree to withdraw their notice in order to gain time to explore alternatives and possibly refile.

If the parties and the government cannot reach agreement on mitigation measures, three things can happen:

1. The parties may withdraw their notice and abandon the deal – if the government approves.
2. CFIUS may “impose” such measures, in which event the parties must accept them or abandon the deal.
3. CFIUS may refer the matter to the president. This is rare, and CFIUS will bend over backwards to avoid it, but it happens. On a finding of “credible evidence that ... the foreign interest exercising control might take action that threatens to impair the national security,” the president may prohibit the transaction or cause it to be unwound. The president’s decision is not reviewable.

LESSON

If you have a transaction that may be covered by the CFIUS regulations, raise the issue early. If a filing may be warranted, your timetable should take it into account.