

CFIUS: Reform, Investments From China, and CFIUS Risk

Implications and Implementation of Foreign Investment Risk Review Modernization Act

THURSDAY, SEPTEMBER 13, 2018

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

Keith Schomig, Counsel, **White & Case**, Washington, D.C.

Andy M. Walker, Managing Director, **Accenture - Strategy**, Arlington, VA

The audio portion of the conference may be accessed via the telephone or by using your computer's speakers. Please refer to the instructions emailed to registrants for additional information. If you have any questions, please contact **Customer Service at 1-800-926-7926 ext. 1.**

Tips for Optimal Quality

FOR LIVE EVENT ONLY

Sound Quality

If you are listening via your computer speakers, please note that the quality of your sound will vary depending on the speed and quality of your internet connection.

If the sound quality is not satisfactory, you may listen via the phone: dial **1-888-450-9970** and enter your PIN when prompted. Otherwise, please **send us a chat** or e-mail sound@straffordpub.com immediately so we can address the problem.

If you dialed in and have any difficulties during the call, press *0 for assistance.

Viewing Quality

To maximize your screen, press the F11 key on your keyboard. To exit full screen, press the F11 key again.

Continuing Education Credits

FOR LIVE EVENT ONLY

In order for us to process your continuing education credit, you must confirm your participation in this webinar by completing and submitting the Attendance Affirmation/Evaluation after the webinar.

A link to the Attendance Affirmation/Evaluation will be in the thank you email that you will receive immediately following the program.

For additional information about continuing education, call us at 1-800-926-7926 ext. 2.

If you have not printed the conference materials for this program, please complete the following steps:

- Click on the ^ symbol next to “Conference Materials” in the middle of the left-hand column on your screen.
- Click on the tab labeled “Handouts” that appears, and there you will see a PDF of the slides for today's program.
- Double click on the PDF and a separate page will open.
- Print the slides by clicking on the printer icon.

CFIUS: Reform, Investments From China, and CFIUS Risk

White & Case

Keith Schomig

keith.schomig@whitecase.com

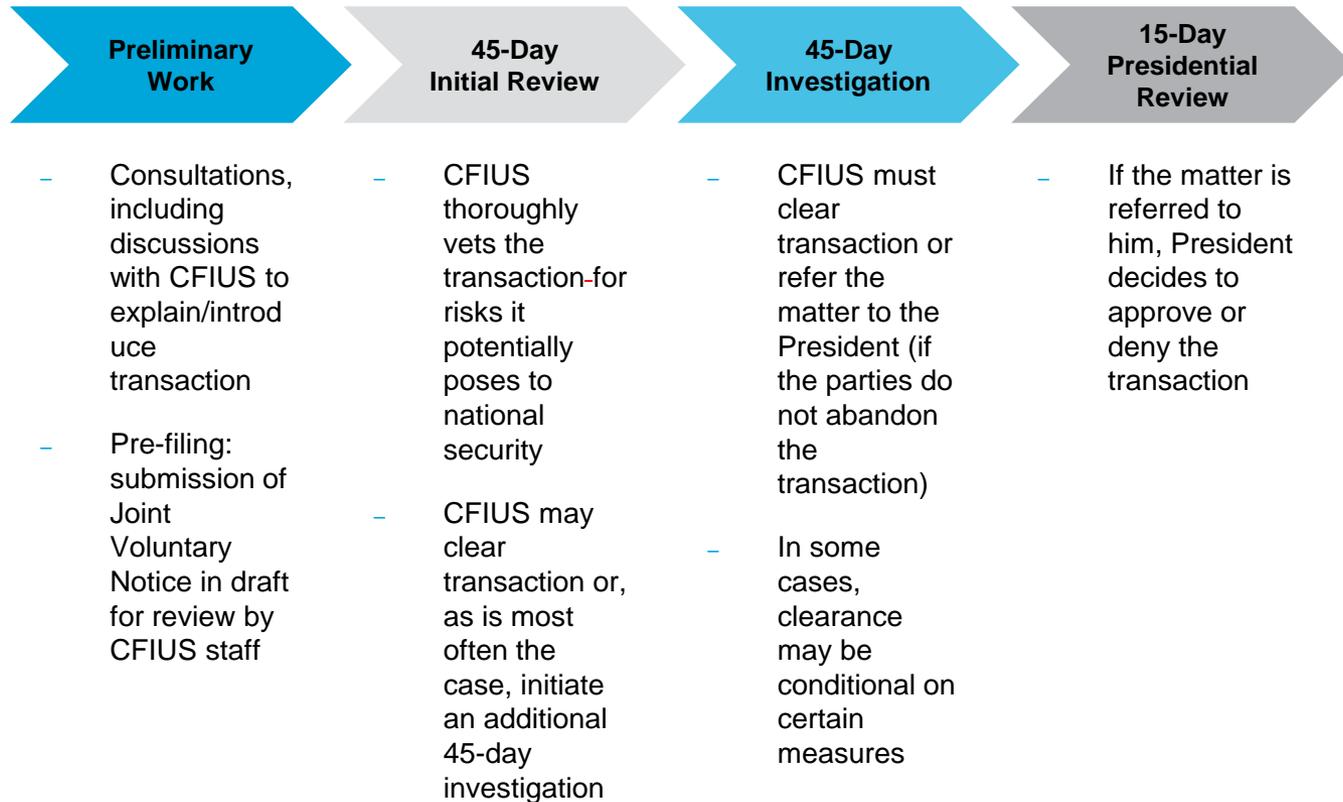
Committee on Foreign Investment in the United States (CFIUS)

- CFIUS is a US government interagency process, chaired by the Treasury Department, that conducts national security reviews of certain foreign investments (called “covered transactions”).
- For each transaction that it reviews, CFIUS’s risk-based analysis considers:
 - **Threat** - whether the foreign acquirer has the capability or intent to exploit or cause harm
 - **Vulnerability** - whether the nature of the US target business creates susceptibility to impairment of US national security
 - **Consequences** to US national security of the combination of the threat and vulnerability
- Process may result in transactions being suspended, blocked, or modified, **even after closing**.
- Parties to a transaction may file with CFIUS to obtain formal clearance of a transaction. This gives the transaction “safe harbor” and prevents CFIUS revisiting the transaction.
- CFIUS is able to review “covered transactions” in every sector.
- In recent years, CFIUS’s caseload has grown dramatically:
 - 2015: 143 reviews
 - 2016: 172 reviews
 - 2017: 238 reviews

Chinese investors accounted for the most filings in each of 2013-2015.

CFIUS Timeline

□ CFIUS Process



Recent CFIUS Reform

- Foreign Investment Risk Review Modernization Act (FIRRMA)
- Two key changes to the CFIUS process:
 - Expands the types of transactions that CFIUS may review
 - Creates a “declaration” process and makes certain declarations mandatory

Expansion of CFIUS “Covered Transactions”

		Who	Transaction Types	Degree of Influence over Target	Target Characteristics	
FIRMA	Pre-FIRMA	1	Any “foreign person”	<ul style="list-style-type: none"> • Merger • Acquisition • Takeover • Joint venture • Long-term lease 	“Control” = power to determine, direct, or decide important matters	Any “U.S. business”
		2	“Certain categories of foreign persons”	<ul style="list-style-type: none"> • Purchase • Lease • Concession 	N/A	Real estate in the United States: <ul style="list-style-type: none"> • air or maritime port, OR • in close proximity to, or that could be used to collect intelligence on or expose national security activities at, certain sensitive U.S. government installations, facilities, or property But excluding: <ul style="list-style-type: none"> • single housing units • potentially, real estate in “urbanized areas”
		3	“Certain categories of foreign persons”	<ul style="list-style-type: none"> • Any investment, direct or indirect 	<ul style="list-style-type: none"> • access to material non-public technical information, • member or observer of board (or equivalent) of the U.S. business, OR • any involvement, other than voting of shares, in substantive decision-making of the U.S. business regarding (i) sensitive personal data of U.S. citizens, (ii) critical technologies, OR (iii) critical infrastructure 	Any “unaffiliated U.S. business” involved in: <ul style="list-style-type: none"> • critical infrastructure, • critical technologies, OR • sensitive personal data of U.S. citizens
		4	Any change in rights, if that change could result in a transaction of the type in (1) or (3).			
		5	Any other transaction, the structure of which is designed or intended to evade or circumvent CFIUS jurisdiction.			

Declarations – Some Mandatory

- “Declarations” - new streamlined process
- Upon receiving a declaration, CFIUS must take one of four actions within 30 days:
 - Conclude action (confers “safe harbor”)
 - Request that the parties file a full notice
 - Inform the parties that CFIUS is not able to conclude action on the basis of the declaration
 - Self-initiate a full review
- Declarations will be mandatory for certain types of transactions

Other Changes to CFIUS

- ❑ Extended initial review timeline (30 days → 45 days)
- ❑ More resources for, and attention to, mitigation monitoring
- ❑ More robust non-notified process
- ❑ Potential filing fees
- ❑ Allied engagement

Key Lessons from FIRRMA

- National security concerns with Chinese investment are long-standing and widely held. CFIUS's increased scrutiny will likely outlive any shorter-term US/China trade tensions.
- Chinese investment in the following US targets will face increased scrutiny by CFIUS:
 - Real estate in sensitive areas
 - Infrastructure
 - Technology
 - Businesses possessing or having access to sensitive data

Key Lessons from FIRRMA

- CFIUS remains a transactional review process – not an outright restriction on Chinese investment.
 - We expect that CFIUS will continue to clear Chinese transactions that do not, in its view, pose any national security concerns.
- Importance of experienced CFIUS counsel –
 - assessing CFIUS risk in a potential transaction
 - structuring the transaction
 - if necessary, shepherding the transaction through the CFIUS process

Example: Private Equity

- Challenge: Increased CFIUS focus on private equity. Concerns that Chinese “limited” partners could nonetheless gain access to sensitive technical information or otherwise influence the operations of an investment fund’s US portfolio companies.

- Opportunity: FIRREA excludes from the new non-passive, non-controlling category of “covered transactions” (type (3) in the previous chart) certain private equity-type investments, so long as:
 - Fund managed exclusively by a US general partner/manager
 - Fund’s advisory board/committees cannot control investment decisions of the Fund or any decisions of the GP/manager related to portfolio companies
 - Foreign LP cannot:
 - control the fund (including unilaterally dismiss, select, or determine compensation of the GP/manager)
 - access any material non-public technical information
 - be a member or observer to the board of any U.S. business portfolio company; or
 - have any involvement in substantive decision-making of any U.S. business portfolio company

CFIUS Best Practices

- Conduct thorough due diligence
 - This enables parties to assess potential national security concerns and develop possible solutions upfront — as well as to have a better foundation for negotiating CFIUS risk within the transaction
- Consult with CFIUS prior to filing a joint voluntary notice
 - This can help shape expectations early on, and set the tone and direction of issues to be considered
- Brief stakeholders on issues related to the transaction
 - Specifically, discuss items of potential controversy with interested government agencies
 - If the deal is likely to be high profile, a public relations campaign may also be appropriate
- Advocate and focus on business
 - Demonstrate that the transaction is driven by a commercial rationale
 - Anticipate and respond to potential national security concerns within the CFIUS notice, with particular focus on the areas of potential concern learned during due diligence
- Have a problem-solving mentality
 - Seek to address potential national security concerns proactively

Questions?



High performance. Delivered.

CFIUS & its Impact on Mergers

Operational Impacts of CFIUS Mitigation Measures

September 2018

Agenda



1. CFIUS OVERVIEW



2. US GOVERNMENT CUSTOMER DATA



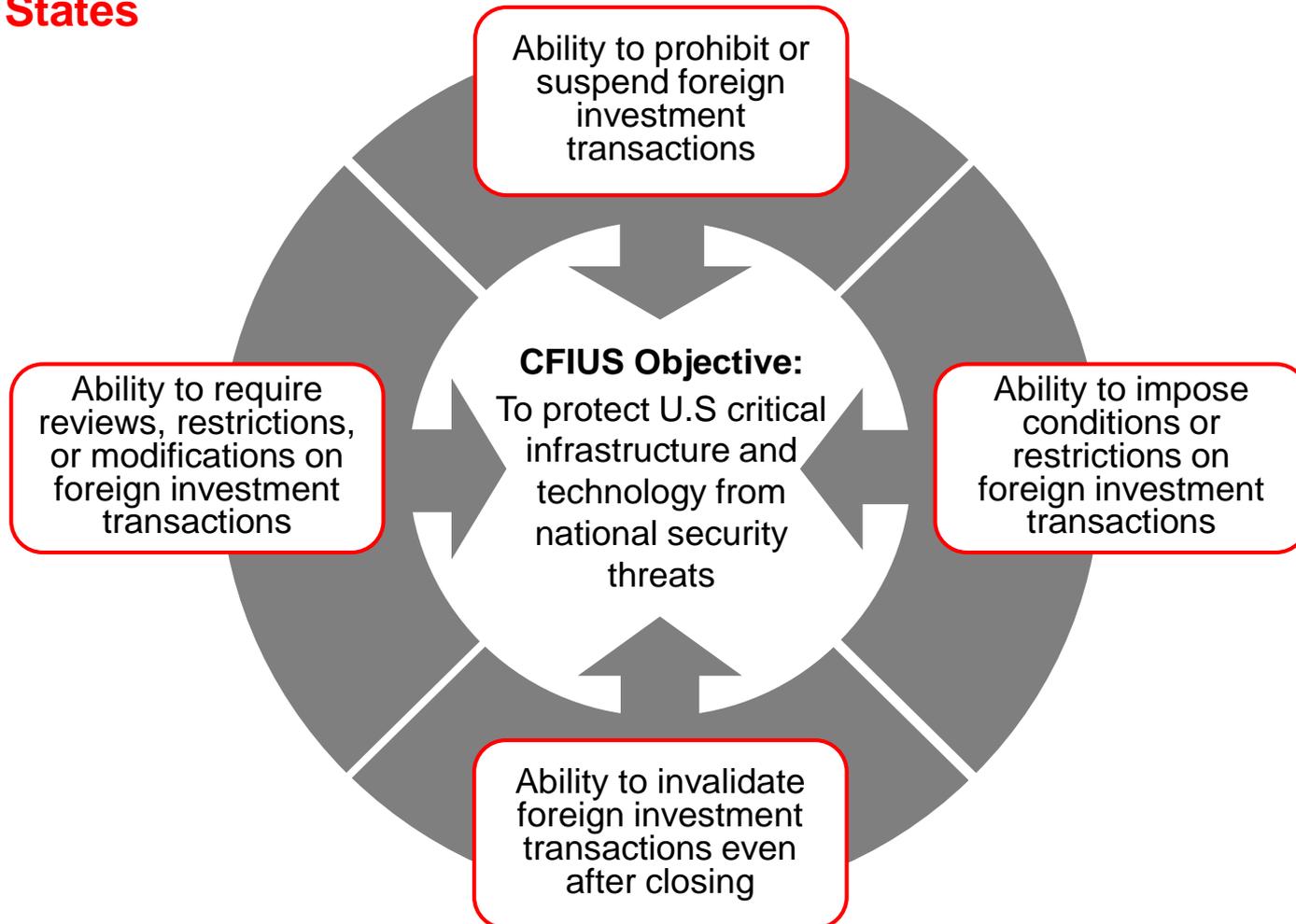
3. BUSINESS IMPACTS



4. LEADING PRACTICES

CFIUS Overview

The Committee on Foreign Investment in the United States (“CFIUS”) conducts national security reviews of foreign direct investment into the United States



Recent Trends

A number of recent developments increase the importance of planning for CFIUS compliance at the beginning of M&A activity

1. Increased workload on CFIUS is slowing the review process
2. CFIUS agencies are reviewing transactions through the lens of larger geopolitical and industrial policy issues
3. Protecting US Government (USG) Customer Data has become increasingly difficult due to increased interconnectivity among companies, USG customers, third party service providers and other suppliers
4. CFIUS agencies seem increasingly open to accepting template compliance models to de-risk issue areas
5. Full impact of the Foreign Investment Risk Review Modernization Act (FIRRMA) of 2018, may not be felt or known for several years

Foreign Investment in US

Foreign investment in key segments often triggers CFIUS engagement that can create ongoing operational challenges

Situation

- CFIUS is increasingly focusing on USG Customer Data in its mitigation agreements resulting in increased costs and operational burdens on companies
- Some requirements from the USG have included:
 - Creation of stand-alone business entities
 - Agreements to disallow USG customer data from being provided to the parent
 - The use of third-party auditors and monitors to evaluate whether USG customer data is adequately controlled

Complication

- The scope and severity of USG requirements is situational - it varies based on the perceived level of foreign risk
- Types of USG customer data is often ambiguous and CFIUS mitigation agreements typically use words like “any” and “all” which broadens the impact
- Tight timelines often make negotiation on these issues difficult creating a take it or leave it situation

What is US Government Customer Data?

USG Customer Data definitions can vary and can be broader than expected

The term “US Government Customer Data” generally encompasses information that, if exposed, could reveal product or service details to foreign entities. CFIUS agreements attempt to mitigate disclosure risk.



Names of USG Agencies or Personnel



USG Agency Contractual Information



USG Agency Financial and Usage Records



USG IP Addresses



USG Customer Telephone Numbers



USG Agency Email Addresses

CFIUS often views USG Customer Data as sensitive data that must be protected from non-US entities

Requirements to Protect USG Customer Data

USG Customer Data protection requirements are frequently part of CFIUS mitigation agreements, addressing access to the data and the data itself

USG Customer Data



What information is considered USG Customer Data



How USG Customer Data is protected



Where USG Customer Data is stored, including backups and temporary storage locations

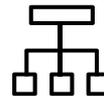
Access to USG Customer Data



Who can access USG Customer Data (US citizen or foreign national requirements)



Where USG Customer Data can be accessed from (domestic or international restrictions)

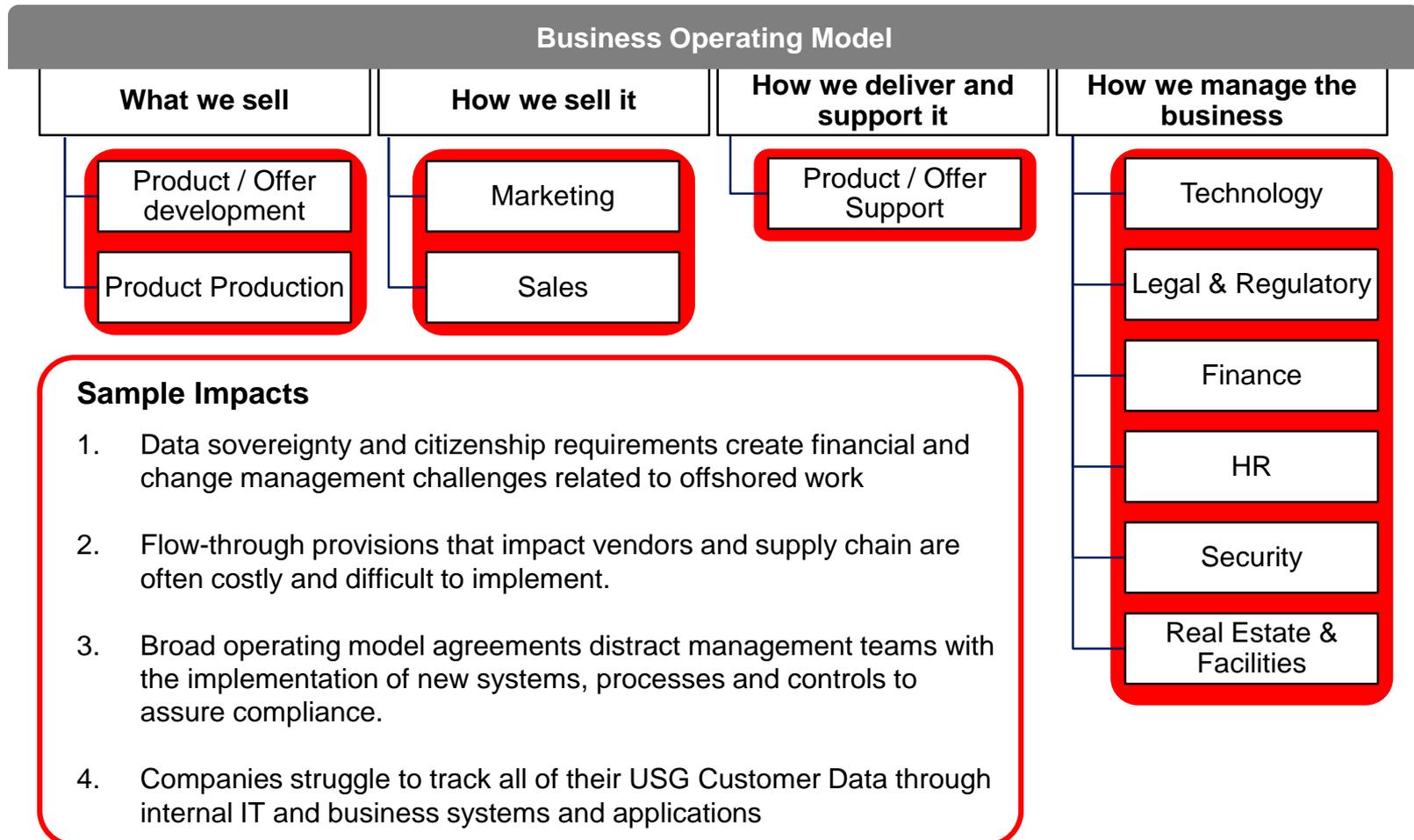


What customer or financial data can be shared with foreign parent company

USG Customer Data protection requirements can have major financial and operational impacts on companies, their third party service providers and other suppliers in the product or service delivery chain

USG Customer Data protection requirements extend across organizations

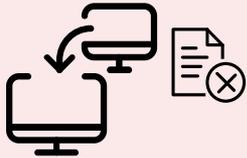
Protecting USG Customer Data can have impacts throughout a company's business



USG Customer Data Protection Options

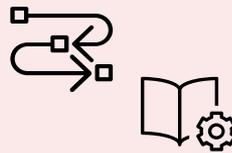
Once companies know where USG Customer Data are located, including third party service providers, they have a number of remediation options

Segregate / Remove



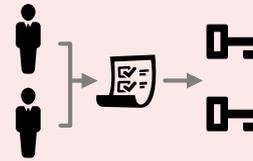
Segregate or remove USG Customer Data from identified applications and systems

Process / Policy



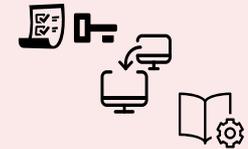
Modify and enhance business processes and policies to protect USG Customer Data within systems

Access Controls



Protect access to USG Customer Data through the continued use of role or location based access controls

Hybrid



Protect USG Customer Data through any combination of technology, process, and policy changes

The right method or combination of methods to protect USG Customer Data will vary depending on the company and its CFIUS negotiated terms

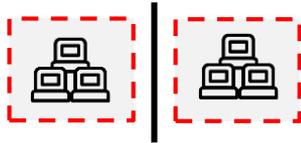
Mitigation Approaches Can Lead to Extra Costs

Integrating separate systems and reducing redundant personnel are key merger considerations; protecting USG Customer Data complicates this

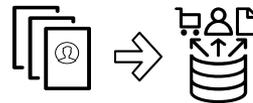
USG Customer Data Protections

Access Control Protections

Mitigation Examples



Air-gapped Network



Manual Business Processes*



US Citizenship



Services On Soil

Added Costs

- Engaging technical experts to create solution pre-deal
- Duplicate infrastructures, applications and networks that are not accessible by non-US entities
- Added employee time for manual data / info sharing processes

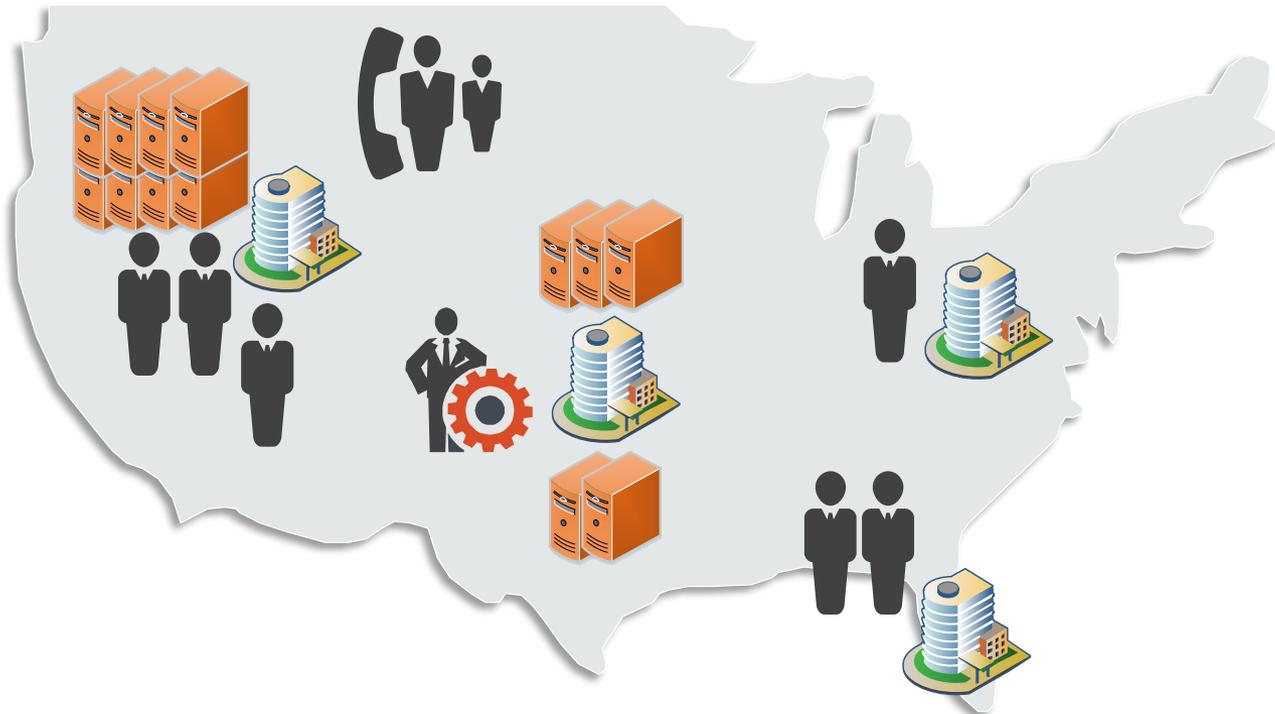
- Establish measures to ensure access to USG Customer Data is strictly limited
- Verify service personnel accessing USG Customer Data are US citizens
- Locate services accessing and managing USG Customer Data onshore

Companies may change how they operate to avoid some of the risks and costs of protecting USG Customer Data within enterprise systems and networks

**Examples include: product tracking, service tracking, billing, financial reporting, employee time reporting*

Example of USG Customer Data Protection Impact on Operational Model

Protecting USG Customer Data may limit company's ability to use non-US based shared services and 3rd party services providers, increasing costs



Access to non-customer data only



Resources outside the US can be utilized to fulfill business functions (e.g., Finance, HR, Procurement) in circumstances where USG Customer Data is not shared outside of the US or with non-US citizens.



Complying with USG Customer Data protection requirements is likely to increase costs

 USG Customer Data & Data Storage

 White List Data

 In House Resource

 External Call Center

 External IT Service Provider

 Offshore Resources

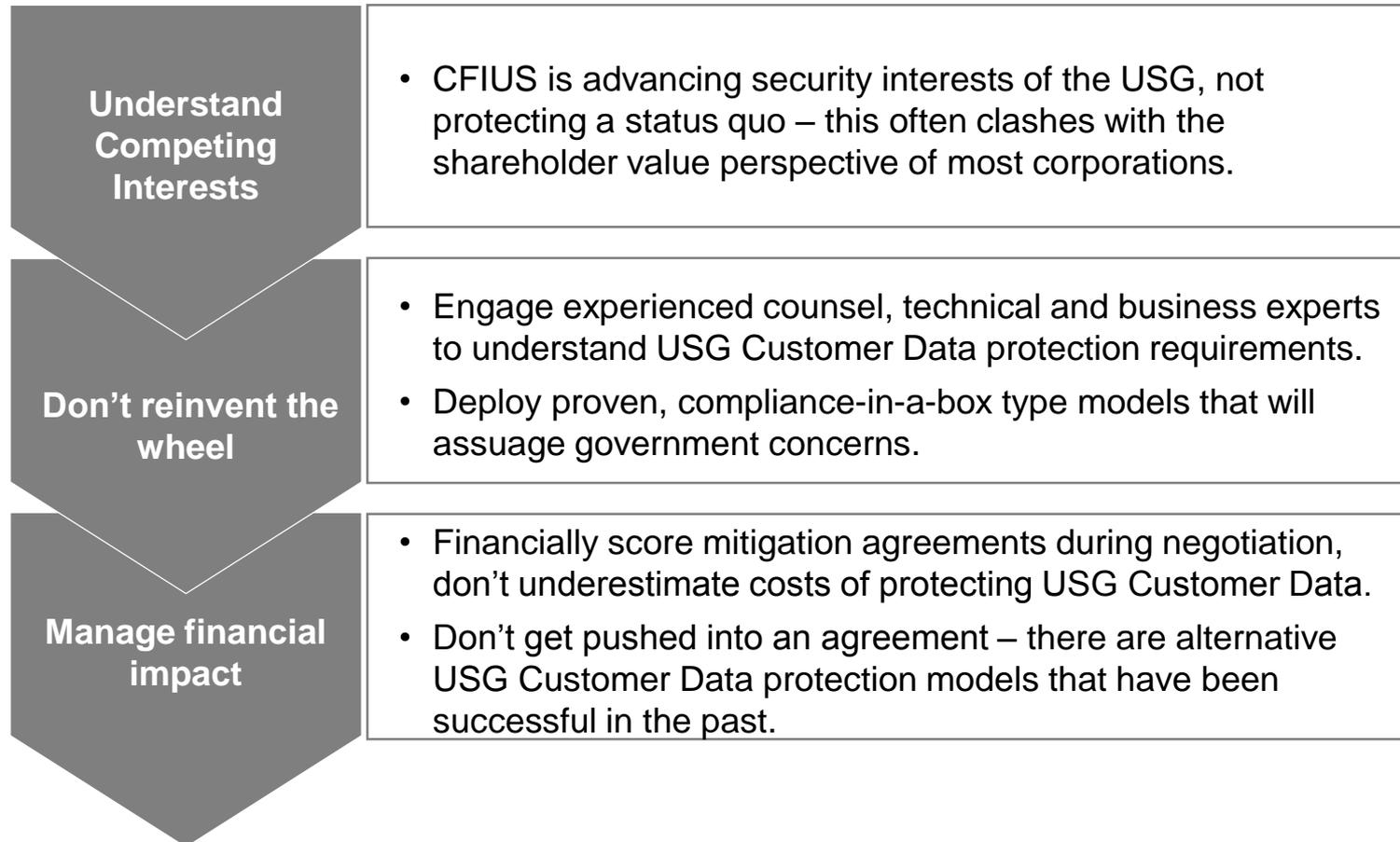
3rd Party Providers

Leading Practices in CFIUS Compliance

Pre-Transaction

The best way to approach national security compliance is to proactively address USG Customer Data protection issues and concerns

Pre-signature Compliance Themes

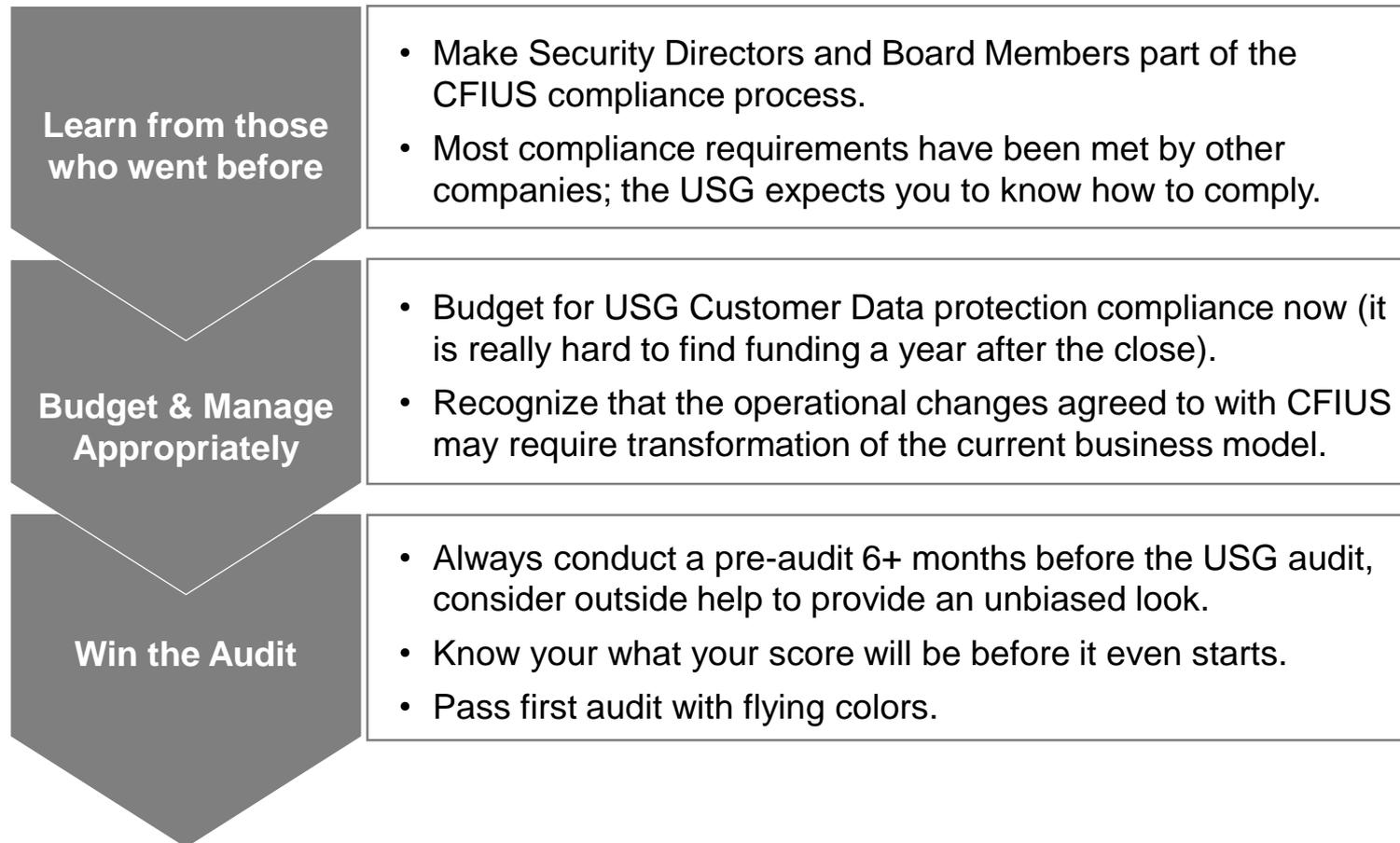


Leading Practices in CFIUS Compliance

Post-Transaction

National security compliance can be challenging – know that there are financially responsible approaches that have been proven to work for the USG in the past

Post-signature Compliance Themes





Andy Walker
Partner
Accenture Strategy
T +1 703 371 4561
andrew.m.walker@accenture.com