

9 Tips To Ensure Deal Success Under Growing CFIUS Scrutiny

In August 2018, Congress enacted the Foreign Investment Risk Review Modernization Act, or FIRRMA. The legislation made sweeping changes to the role of the Committee on Foreign Investment in the United States, attracting the attention of foreign investors and their legal counsel. Draft FIRRMA implementation regulations are due out for public comment this summer.

Last year also proved to be the busiest deal year in the committee's 44-year history, as CFIUS reviewed approximately 243 transactions. However, the number of deals under CFIUS scrutiny is expected to continue to grow exponentially because, prior to the 2018 legislation, it reviewed only controlling foreign investments.

Under the new law, foreign investment such as joint ventures, minority stakes and early stage financing of startups may now be subject to CFIUS review. Foreign investment in "critical technologies" by "countries of special concern" will also now be subject to CFIUS review. Additionally, investments that give access to nonpublic information or technology, provide some type of management control, or acquire an interest in real estate located near sensitive government facilities will be examined.

CFIUS has historically approved most deals, in doing so, however, it has required mitigation or some type of controls in a significant number of approved transactions.

While this updated legislation will impact all foreign investment in the U.S., the driving force behind strengthening the power of CFIUS to oversee a broader range of transactions is in reaction to investments made by China, which were viewed by Congress as a threat to U.S. national security.



Scott Boylan

Senior Adviser

sboylan@stoneturn.com

StoneTurn



The technology industry, and, more specifically, companies that focus on the development of critical or emerging technologies, is expected to feel the greatest impact of these proposed changes. The Pentagon has reported that, in the wrong hands, some of these technologies could jeopardize the safety of American citizens.

Given the expanded scope, it seems timely to provide an overview of CFIUS mitigation procedures for any company considering global M&A opportunities and how they can streamline the process to position the transaction for success.

The CFIUS Process

Once a U.S. entity and a foreign investor agree to a CFIUS-covered transaction, they file a joint voluntary notice, which details the proposed transaction and the history of the parties involved. CFIUS then has 45 days to decide on the transaction. The time period can be extended another 45 days when further investigation is needed or required. In extraordinary cases, CFIUS can refer the case to the president for a final decision. This requires an additional 15 days.

After completing the often arduous CFIUS filing and negotiation process, the next challenge is operating the entity within the constraints of a mitigation agreement or agreements, which are often required and can range from light touches such as a board resolution to onerous restrictions on how a company can conduct its business.

If the business involves classified contracts or the handling of classified information, the company could have both a national security agreement with CFIUS and a mitigation agreement requiring a certain type of corporate structure with the U.S. Department of Defense Counterintelligence and Security Agency.

Below are nine variables that foreign investors and their counsel should implement pre-transaction to ensure a smooth transition in operating the business post-transaction:

1. Anticipate Mitigation or National Security Concerns

Your company has entered into a transaction in the hopes of gaining access to an element of the U.S. market that could, in some instances, involve sensitive and, quite possibly, classified information. Therefore, as a foreign investor, you might expect some form of limitations on how you will operate your U.S. asset.

However, in some cases, foreign investors enter the process fully confident that their mundane target would never be a national security concern, only to learn that the experts believe it is. It is important to evaluate your deal through a national security lens and anticipate concerns in advance. Start planning how you will manage the mitigated U.S. business before the negotiations conclude and, if possible, before they even begin.

2. Check Compliance

A proactive compliance assessment is essential. Is the company as good at export controls, sanctions, supply chain security, cybersecurity, anti-bribery, IP protection as you think?

It is better to review these areas before the CFIUS process begins rather than field questions or identify issues during the CFIUS process. Have there been any incidents? How did the organization address past failures and ensure they will not recur? How is the target doing in these areas?

3. Anticipate Additional Costs

Additional security and oversight requirements can add unexpected costs to business operations and these

requirements should generally be predictable. Include these costs in your deal evaluation and post-closing financial targets.

4. Identify Key People

Key personnel at the acquired company, including individuals who have relationships with customers, should be educated on the deal strategy and why it is positive for the customer. Oftentimes, a well-connected project manager is your best salesperson in the government space; they should also be able to sell the deal to the committee and concerned regulators.

5. Identify Potential Board Members

Mitigated company structures have requirements for independent board members. Identify your board members early in the process. Recognize that these individuals may be running your company and driving your management team. They may need to make key hiring and firing decisions. They should be up to the task and possess a complement of business and government experience. Their views on employee compensation, employee career advancement, compliance, financial targets and culture should be consistent with your company's, otherwise, there will likely be conflict and misunderstandings in the future.

6. Budget for Increased Security and Related Costs

Security is often a significant function in mitigated companies, so it is imperative to pay close attention to the structure and skillset of the security function. More specifically, security is now squarely focused on the IT side, with cyber concerns being of paramount importance.

However, sound security should not be limited to IT alone. A security regime also involves physical security;

recognizing the insider threat is significant in both reality and perception to the U.S. government. Therefore, the chief of security needs to be someone with technical expertise and sit high in the organization, reporting directly to the CEO or board.

7. Comply With Mitigation

Compliance with your mitigation agreements is vital, as CFIUS recently levied a \$1 million fine for failing to establish required security policies and to provide adequate reports to CFIUS. Therefore, putting in place effective policies, procedures and a culture of compliance is essential.

To be successful, ensure you: build a good security and compliance team; demand a culture focused on security and compliance; self-test and self-audit for compliance; and train your employees so they fully understand their responsibilities and the commitments of the company. Additionally, seeking objective, third-party validation is highly recommended to bolster your credibility with the government.

8. Company-Wide Training

Training should not only be limited to personnel in the mitigated company, but should extend to employees throughout the organization, including board members and especially those employees outside the mitigated company who will frequently be engaged with the mitigated company.

9. View Mitigation From Customer Perspective

Evaluate your commitments to CFIUS through the eyes of the customer. Many customers see a higher level of security as a net positive or even an absolute requirement. The mitigation terms could, therefore, be a part of your sales pitch to customers and can be positioned as a competitive advantage.

Conclusion

Given the renewed and significantly expanded focus of CFIUS oversight on transactions with foreign organizations and investors, these steps will help companies navigate the stringent CFIUS requirements pre- and post-transaction.

While companies looking to expand into the U.S. market should now expect a higher level of security requirements, and with it a higher level of expense, it is important to remember that, absent these restrictions, foreign investors would otherwise be precluded from involvement in these lucrative U.S. businesses.

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