

# Three Steps to Prepare for CFIUS Switch to Export Control Standard

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*by Scott Boylan and Joshua Holzer*

As Foreign Investment Watch readers are well aware, new regulations go into effect that require a mandatory application be filed with the Committee on Foreign Investment in the U.S. (CFIUS) if a transaction involves technology or services regulated by U.S. government permission or an export license. For example, starting on October 15, if a widget requires an export license to be shipped to China, a Chinese investor or purchaser involved in a deal with the U.S. maker of that widget would trigger a mandatory filing with CFIUS. If that same widget does not require a license when being shipped to Germany, a German investor would have no mandatory filing requirement for the same investment. This change should make mandatory filing requirements with CFIUS more predictable, but also argues for earlier consideration in the deal cycle of the impact of a CFIUS national security review on investments and deals.

In fact, CFIUS clarifies in its final rule that it expects a mandatory filing to be made in the early stages of a transaction, not after all terms have been negotiated and the deal documents are ready to be signed. This supports the argument for early preparation and understanding of the technology and export control landscape before moving too far forward with a transaction. Viewing these matters from a national security regulator's perspective, discussions involving export-controlled technology with a potential prohibited investor should be avoided or, at minimum, properly mitigated. Depending on the



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technology and level of detail, the conversations could be viewed as an “export,” leading to more complications and potential regulatory violations, adding yet another reason advance preparation and knowledge of the export landscape surrounding a transaction is so important.

Investors and companies should prepare by taking the following three steps:

## **Understand the Export Landscape**

Investors and their deal teams should develop a general familiarity with technologies and destination country pairs that result in an export license requirement. This knowledge base will assist in determining when CFIUS mandatory filings are required and any consequent impact on deal timing.

Only with this background can investors truly develop sound strategies on deal focus, structure and type that should be contemplated based upon the unique circumstances of an individual or organization.

## **Check Export Compliance**

A renewed focus on export control requirements means there will be increased scrutiny by CFIUS on export control compliance. All entities in a transaction should expect that their past behavior in complying with export control requirements will be placed under a microscope by the U.S. government.

Pre-deal is the best time to review all parties’ compliance practices and test their strength. During a CFIUS review is the worst time to learn that a portfolio company, subsidiary, or your own

organization has had a major export compliance failure. Not only could this discovery have serious consequences for the deal at hand, it could have a significant impact on future CFIUS deal approval. A bad reputation with CFIUS can live on for years to come and can be avoided with proactive and holistic evaluation, preferably conducted in-depth by a third party.

A thorough export control evaluation should begin with a review of the organization’s export control compliance program, including policies, procedures and past issues. Any promises made to, or requirements imposed by, the U.S. government in connection with settlements from past violations should be documented, and an assessment as to whether the current program still complies with what was envisioned should be performed. Particular attention should be given to alignment with recordkeeping requirements and the use of automated tools to bolster compliance processes.

Next, dealmakers should thoroughly understand where the company’s technology and products fit into the export control framework based on their classification. Certain technology and products are subject to more stringent controls and extra time should be taken to confirm that applicable controls are in place, including any necessary technology control plans. Finally, the proposed destinations for such technology and products, as well as related licensing requirements and any exemptions that may apply should be determined.

Since the export control classification of relevant technology and products will form the basis of a CFIUS review, how the company handles its export compliance program is likely to provide a good litmus test on how confident CFIUS is in the company’s ability to mitigate risks posed by a transaction.



## Expect Mitigation with Approval

CFIUS approval of a mandatory filing is likely to come with some mitigation or control provisions. Since the recent passage and implementation of the Foreign Investment Risk Review Modernization Act (FIRRMA), there has been an increase in CFIUS imposed mitigation requirements.

Common mitigation requirements include limits on communications with the foreign parent, independent board member or members, independent monitors/auditors, separate IT systems, and/or separate facilities. Understanding that complex conditions for CFIUS approval may be required early in deal strategy formulation can

contribute to better outcomes. Clearly, mitigation requirements can have significant cost and time implications that must be evaluated, ideally well before the ink on a transaction is dry.

CFIUS' move to an export control classification standard should be viewed as a net positive for the investor and deal-making community. But, while mandatory filings will be much easier to predict, there will be a need for earlier due diligence in subject transactions. A baseline understanding of the export landscape and strong compliance practices will help dealmakers avoid transaction failures and best leverage CFIUS' new approach.



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