

CFIUS Mitigation: Anticipating Requests, Structuring Agreements, Implementing Mitigation Measures

TUESDAY, DECEMBER 19, 2017

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

Today's faculty features:

Barbara D. Linney, Member, **Miller & Chevalier** Chartered, Washington, D.C.

Karalyn Mildorf, Counsel, **White & Case**, Washington, D.C.

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. 10.**

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 **1-866-927-5568** 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. 35.

Program Materials

FOR LIVE EVENT ONLY

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 Mitigation: Anticipating Requests, Structuring Agreements, Implementing Mitigation Measures

Tuesday, December 19, 2017

1:00 p.m. to 2:30 p.m. EST | 10:00 a.m. to 11:30 a.m. PST

Presented by

Barbara D. Linney

Member

Miller & Chevalier Chartered

Karalyn Mildorf

Counsel

White & Case LLP

Outline

- Anticipating Mitigation Requests
 - What steps can counsel take to anticipate CFIUS mitigation requests
- Mitigation Agreements
- Managing Mitigation Pitfalls
 - How can counsel identify and analyze potential mitigation pitfalls that could impact the deal?
 - What best practices can counsel employ to evaluate the impact of mitigation on the transaction structure?
- Implementing Mitigation Measures After the Transaction

CFIUS Overview

- The Committee on Foreign Investment in the United States (CFIUS) conducts national security reviews of foreign direct investment into the United States
- The CFIUS statute is the Exon-Florio Amendment to the Defense Production Act of 1950 (50 U.S.C. § 4565), which was enacted in 1988, amended in 1993, and overhauled in 2007 with the passage of the Foreign Investment and National Security Act of 2007 (Pub. L. 110-49, 121 Stat. 246)
 - The CFIUS regulations are found at 31 C.F.R. Part 800
- Current CFIUS members:
 - The Secretaries of Treasury (Chair), Homeland Security, Commerce, Defense, State and Energy, the U.S. Attorney General, the U.S. Trade Representative, and the Director of the Office of Science and Technology Policy
 - On a case-by-case basis, the President or the Secretary of the Treasury can appoint the head of any other executive department, agency, or office
 - The Secretary of Labor and the Director of National Intelligence are *ex-officio*, non-voting members
 - The following are observers appointed by the President: the Director of the Office of Management and Budget, the Chairman of the Council of Economic Advisers, and the Assistants to the President for National Security Affairs, Economic Policy, and Homeland Security and Counterterrorism
- Where CFIUS has national security concerns about a transaction, it can require mitigation measures to address those concerns or object to the transaction

Recent Trends

- Most cases continue to be approved without mitigation requirements
 - 10% of cases from 2013-2015 required mitigation, per the most recent CFIUS Annual Report
- The number of CFIUS filings is reaching record levels – around 230 so far this year – leading to longer review times in complex cases, including where mitigation terms are under discussion
- CFIUS has been addressing some mitigation requirements in one review cycle, but more complex cases may require withdrawal and resubmission to provide additional time
- Mitigation requirements can significantly impact operations, so it is critical to assess potential concerns and mitigation measures at the front-end of a transaction
- Recently, CFIUS has seemed less inclined to use broad mitigation measures in sensitive cases
- CFIUS still is more likely to impose mitigation or recommend the parties abandon a transaction than to recommend to the President that a deal be blocked

Anticipating Mitigation Requests

- Due diligence
 - Look for factors that give rise to national security concerns or mandatory mitigation requirements
 - Understand when CFIUS or other agencies can require mitigation
- Purchase agreement terms
- Preemptive mitigation?
- CFIUS reform – how will this impact CFIUS mitigation posture going forward?

Anticipating Mitigation Requests – Due Diligence

- Potential risk factors to look for during due diligence:
 - Factors specific to the target business
 - Factors specific to the foreign person
 - Factors specific to the country of origin of the foreign person
- Factors specific to the target business:
 - Critical technology (*i.e.*, products, services and technology subject to the International Traffic in Arms Regulations (ITAR) or controlled on the Commerce Control List (CCL); facilities and items controlled under 10 C.F.R. parts 810 and 110; regulated special agents and toxins)
 - Critical infrastructure (*e.g.*, energy, transportation, communication and financial systems; natural resources)

Anticipating Mitigation Requests – Due Diligence (*cont'd*)

- Factors specific to the target business (*cont'd*):
 - Government licenses (*e.g.*, Federal Communications Commission (FCC), Department of Energy, Nuclear Regulatory Commission)
 - Government contracts (prime or sub / sole source)
 - Facility or public trust clearances / access to classified information
 - Other significant interactions with U.S. government or CFIUS member agencies
 - Proximity to government installations / critical infrastructure
 - Industries in which CFIUS has previously required mitigation, including defense & aerospace, law enforcement, intelligence, information technology, cryptography, data protection, internet security, network intrusion detection, *etc.*
- Factors specific to the foreign person:
 - Foreign government-control of acquiring entity
 - History of commercial espionage

Anticipating Mitigation Requests – Due Diligence (*cont'd*)

- Factors specific to the foreign person (*cont'd*):
 - Evidence of coordinated strategy to acquire companies with critical technology
 - Plans for the business (including any plans to terminate U.S. government contracts)
 - Nationality of acquiring entity and countries in which it operates
 - Business with sanctioned countries
- Factors specific to the country of origin of the foreign person:
 - Non-proliferation record of country of origin
 - Record of cooperation of country of origin with U.S. counter-terrorism records
 - Support of country of origin for Arab League boycott of Israel

Deal Planning & Purchase Agreement Terms

- After conducting due diligence, parties should have a clearer sense of potential national security concerns and anticipated mitigation-related risks
- In negotiating the transaction, parties have to carefully consider allocation of CFIUS risks, balancing deal certainty with the potential for mitigation to be imposed
 - Buyers and sellers have different priorities, so it is key to find an acceptable balance among the parties' interests
- Address key terms in the purchase agreement
 - Representations and warranties
 - Covenants
 - Conditions precedent
- Build sufficient time into the deal process, particularly since the CFIUS process has been taking longer

Pros and Cons of “Preemptive Mitigation”

- Consider whether any mitigation measures are clearly necessary for the transaction to succeed
 - *e.g.*, divestment of businesses subject to control under the ITAR if the buyer is Chinese
- Structural vs. behavioral mitigation considerations
- Consider when and how to address proposed mitigation
- Avoid negotiating against yourself

Anticipating Mitigation Requests – CFIUS Reform

- Legislation currently pending in Congress would reform the CFIUS process and expand its authority
 - Several bills have been tabled in both the House and the Senate, but S. 2098, introduced on November 8, 2017 by Senators Cornyn, Burr, Feinstein, and others, seems most likely to be enacted in some form due to bipartisan and executive branch support
- Proposed changes to both CFIUS process and scope of CFIUS review likely will impact the CFIUS mitigation process
- Proposed process changes contained in S. 2098 include:
 - Lengthening the CFIUS process by extending the 30 day review period to 45 days and giving CFIUS the authority to extend the 45 day investigation period by 30 days
 - This could result in more mitigation cases being resolved in one cycle (*i.e.*, without the need to withdraw and refile)
 - Limiting mitigation agreements to circumstances in which mitigation will be effective, allow for compliance in an appropriately verifiable way, and enable effective monitoring
 - Enhanced compliance monitoring

CFIUS Reform (*cont'd*)

- Proposed changes to the scope of CFIUS review with potential impact on mitigation requirements include:
 - Review of transactions involving certain joint ventures or emerging technologies or non-public information necessary for development and manufacture of critical technologies
 - Expanded definitions of “critical technology” and “critical infrastructure”
 - Consideration of the effect of transaction on U.S. technological and industrial leadership
 - Consideration of history of foreign person’s compliance with U.S. immigration laws
- Other provisions would formalize CFIUS jurisdiction over transactions involving transportation assets, proximity to U.S. government installations, *etc.*
- Separate legislation sponsored by Senators Crapo and Grassley would expansion CFIUS membership to include the Secretaries of Agriculture and Health and Human Services as permanent members and expand CFIUS jurisdiction to include transactions involving agriculture and food safety

Types of CFIUS Mitigation Agreements

- National Security Agreement
- Letter of Assurance
- Letter Agreement
- Administrative Order
- Interim Administrative Order

Common Issues Addressed in Mitigation Agreements

- Protecting sensitive information
 - including personally identifiable information
- Supply chain security
- Ensuring continued supply to the U.S. market
- Cyber security
- Trade compliance
- Maintaining certain information or technology in the United States
- Close proximity concerns

Examples of Mitigation Measures

- Physical and/or electronic access restrictions
- Restrictions or requirements on technology integration
- Requirements for handling sensitive information
- Governance provisions, including one or more independent directors, establishment of a security committee, and appointment of one or more security officers to monitor compliance with mitigation requirements
- Personnel requirements
- Protocols to ensure product integrity
- Continued supply assurances
- Approval from CFIUS prior to making certain business decisions
- Exclusion of assets from the transaction
- Development and implementation of compliance plans
- Independent audits
- U.S. government oversight of and access to the U.S. business

Related Processes – DSS FOCI Mitigation

- Required by Department of Defense 5220.22-M, National Industrial Security Operating Manual (NISPOM)
- Defense Security Service (DSS) administers NISPOM provisions requiring mitigation of foreign ownership, control or influence (FOCI) over companies who hold security clearances permitting access to classified information
- In the context of effective ownership or control, Special Security Agreements and Proxy Agreements are the most common mitigation measures
 - Special Security Agreement (SSA)
 - Used when a foreign entity effectively owns/controls a cleared company
 - Access to proscribed information (TS, SCI, SAP, COMSEC, RD) may require a National Interest Determination (NID)
 - Requires U.S. Outside Directors, Government Security Committee, and various access controls
 - Proxy Agreements (PA) / Voting Trust Agreements
 - Generally used when highly classified information or sensitive technology is involved
 - Proxy Holders/Trustees generally operate independent of foreign owner

DSS FOCI Mitigation (*cont'd*)

- Other mitigation instruments may be required in cases involving minority ownership, with the specific mitigation agreement dependent upon whether the foreign person is entitled to appoint a representative to the cleared U.S. company's board of directors
- PAs generally are viewed as more restrictive and less palatable to foreign buyers, but SSAs may lead to operational challenges if NIDs are required
 - Going into the FOCI mitigation process, the parties should ensure that they fully understand the requirements and pros and cons of each approach
 - CFIUS must be advised of DSS or other FOCI mitigation efforts that are being undertaken outside of the CFIUS process
- DSS typically allows the parties to proceed with a change of ownership to proceed pursuant to a signed "Commitment Letter" and finalize the mitigation agreement post-closing
- CFIUS may defer to DSS mitigation but may still require its own mitigation measures if a member agency makes the case that a national security risk is posed by the covered transaction and additional measures are reasonably necessary to mitigate risks that are not adequately addressed by the DSS mitigation measures
 - *e.g.*, if only a portion of the U.S. business is subject to the DSS FOCI mitigation process

Related Processes – DOE FOCl Mitigation

- The Department of Energy (DOE) and the Nuclear Regulatory Commission (NRC) also administer FOCl mitigation programs
 - *e.g.*, DOE O 470.4B Safeguards and Security Program
- DOE generally prefers Proxy Agreements over Special Security Agreements
- DOE may consult with DSS during process and may defer to DSS in cases in which both programs apply, but would still maintain control over any required NID
- DOE process is less transparent and generally lengthier than DSS process
- Typically requires completion of mitigation agreement and issuance of NID before allowing transaction to proceed

Related Processes – Team Telecom

- Team Telecom reviews national security implications of transactions involving FCC licenses under Section 214 of the Communications Act of 1934
 - Considers national security, law enforcement, foreign policy, or trade concerns in reviewing Section 214 applications involving 25% foreign ownership
- Team Telecom includes the Departments of Justice (including FBI), Homeland Security, and Defense
- Key distinctions from the CFIUS process:
 - Team Telecom review is not voluntary – review is triggered by an FCC filing
 - Team Telecom review is not subject to specific time limits
 - Although the agencies coordinate their views, consensus is not required and the FCC will impose mitigation at the request of any agency
 - Mitigation is generally a condition of the FCC license, and violations can lead to license revocation
- Mitigation typically addresses:
 - U.S. government access to information, including via company records and cooperation with law enforcement and intelligence agencies
 - Security of U.S. government communications
 - Denial of access to foreign governments

Managing Mitigation Pitfalls

- Manage expectations for negotiations and timing
- Realistic assessment of how CFIUS mitigation process can affect deal timing
- Consider practical effects of mitigation and avoid overpromising
- Understand that mitigation will not always be feasible or possible
- Recognize that CFIUS considers information in its reviews that may not be known by the parties, so it is possible for issues to arise beyond those identified in due diligence

Implementing Mitigation Measures

- Understand going in that mitigation does not end with signing the agreement
- Take a collaborative approach – the buyer and target company both have an interest in mitigation working successfully
- Consider timing and transition steps for implementation, including where requirements take effect quickly
- Devote adequate qualified personnel and resources to implementation and oversight
- Be agile to best adapt to new requirements

May We Take Your Questions?

Barbara D. Linney

Member

Miller & Chevalier Chartered

+1 202 626 5806

blinney@milchev.com

Karalyn Mildorf

Counsel

White & Case LLP

+1 202 626 6489

karalyn.mildorf@whitecase.com