UNITED STATES: INCREASED RISK OF POST-ACQUISITION CFIUS REVIEW

Interview with Jason Chipman, Partner at the law firm of WilmerHale, Washington, D.C., USA

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Jason Chipman is a leading attorney in matters related to data security, Committee on Foreign Investment in the United States (CFIUS) and related regulatory issues.

It's not obvious to foreign investors what CFIUS is. How do you approach the issue so that they are well informed?

Jason Chipman: CFIUS, the Committee on Foreign Investment in the United States, is a U.S. Executive Branch committee that has the power to review (i) investments where a foreign person acquires "control" of a U.S. business, (ii) investments that do not constitute control but provide a foreign investor with special rights or access to U.S. businesses associated with certain sensitive industries, or (iii) certain types of real estate investments where the property at issue is in proximity to sensitive government facilities.

It is also important for investors to understand that some foreign investments into companies associated with sensitive technologies, critical infrastructure, or large amounts of personal U.S. citizen information, may trigger a mandatory CFIUS notice requirement. In such a case, both parties (i.e., the target company and the foreign company) must notify prior to closing their intention to complete the transaction. If a transaction does not fall under the mandatory regime but otherwise triggers CFIUS jurisdiction, it is subject to the voluntary regime of CFIUS.

When CFIUS reviews a transaction, the Committee has substantial power over the transaction. Essentially, CFIUS can do one of three things. First, CFIUS can clear a transaction. Once a transaction is cleared, the transaction parties generally have safe harbor from further review by the Committee. Second, CFIUS can clear subject to the parties entering into a mitigation agreement with the U.S. government to address some perceived national security risk. Third, CFIUS can recommend that the President of the United States block or prohibit the transaction.

Most often transactions subject to CFIUS trigger the voluntary regime. In that situation, the question for foreign investors is often whether they want to proceed

with a CFIUS closing condition or no closing condition. As a practical matter, that question is analyzed by evaluating whether there is a serious risk that CFIUS could demand a review of the investor (if there is no voluntary filing) and, in doing so, potentially do something that is disruptive to the perceived economic value of the deal. Put another way, when a French company wishes to acquire an American company manufacturing ice cream cones, the risk of a review by CFIUS - if the transaction is carried out without prior consultation - is very likely to be low. If, on the other hand, a foreign investor wishes to acquire an American defense company or a company making advanced semiconductor technology, such a transaction would be hard to pursue without prior consultation with the committee.

You mention the condition precedent in the investment contract; what are the most appropriate legal tools to limit the regulatory risk associated with CFIUS?

Jason Chipman: It is often very important for a foreign investor to get comfortable that an investment does not trigger a mandatory filing requirement. The CFIUS mandatory reporting regime generally is triggered when the target company develops or designs sensitive technology subject to U.S. export controls (or for certain targets if the investor is controlled by a foreign state). Often foreign investors seek representations in deal documents as to the status of the target company technology to try to rule out a mandatory filing requirement. If the transaction is subject to the mandatory regime and the parties fail to comply with their prior declaration obligations, then the committee has the power to review the transaction and impose a fine that may be equal to the amount of the transaction, or even terminate it.

In practice, it is true that the parties sometimes wish to obtain a legal opinion on a particular investment. If the transaction is subject to the voluntary regime, practitioners will approach the subject in terms of risk, as there can be no certainty as to the assessment of a case by CFIUS. Historically, CFIUS has focused on transactions involving companies operating in sensitive economic sectors (e.g., telecommunications, defense, aerospace, energy). Over the past 15 years, CFIUS has broadened its scope of work. Today, any transaction involving a company in the technology sector can attract CFIUS' attention (e.g., artificial intelligence, personal data protection). When there is uncertainty as to the assessment of the transaction by CFIUS, it is necessary to verify whether the transaction requires a contractual condition precedent imposing prior consultation of the committee.

The notion of risk is at the heart of the review, i.e., a risk on the feasibility of the transaction, on the timeline of the transaction, on the type of investor and investment, but also on the reputation of the foreign investor in the United States (i.e., the committee has always validated the investor's previous projects).

The more sensitive a transaction is, such as semiconductor technology, the more practitioners will advise the investor of the risk that CFIUS may take an interest in the transaction.

Do the new rules that went into effect in October 2020, mandating CFIUS reporting of transactions that involve export-controlled technology, simplify this CFIUS risk assessment for the investor?

Jason Chipman: The mandatory regime makes CFIUS an important issue to evaluate for nearly all foreign investment in the United States. In this regard, the new regime complicates M&A activity and fund raising. With that said, it is also true that the new rules provide a degree of technical clarity about what does and does not trigger a mandatory filing as compared to the rules that existed previously.

For U.S. businesses, however, this regime often creates real challenges because this mandatory export technology control regime requires U.S. companies to evaluate their technology under the export control regime even if they never had the opportunity to sell their products abroad. This regime is quite complicated from a regulatory standpoint.

Who is consulted by the committee? Who takes the initiative? How involved is the White House?

Jason Chipman: The CFIUS process can seem opaque. However, lines of communication are always maintained between the agencies involved and with the parties to the investment in the CFIUS reporting process.

It should be remembered that the committee is a true committee of different agencies, each with its own mission and resources. The Treasury Department is the entity that communicates most with stakeholders and remains at all times the entity responsible for implementing the review of the proposed transaction. There will always be a second department designated as co-lead by the committee, depending on the issue being addressed. For example, when the transaction involves semiconductor technology, then the agency co-responsible for oversight will likely be the Department of Defense or the Department of Energy. When the transaction involves the telecommunications sector, the designated co-lead department will be either

the Department of Justice or the Department of Homeland Security.

The committee must decide by consensus whether the transaction presents a risk to national security. The process can be quite lengthy because of the involvement of several departments in the decision-making process ("interagency process"), giving the impression of a black box of bureaucratic inertia.

In general, throughout the process, the Committee members will discuss with the parties and may even invite them to meet to discuss possible risks and issues arising from the operation. It is not uncommon for the parties to meet with the committee if the transaction presents complicated issues. The Committee then informs the parties of its final decision and may, if necessary, impose conditions on the transaction that are designed to limit the identified risks ("mitigation conditions").

What were the consequences of the health crisis? What about the supply chain issues raised by the pandemic?

Jason Chipman: In the US, the pandemic has highlighted supply chain issues in some key sectors. The government realized that some key elements of the supply chain were not properly subject to review at the national level. The pandemic has also highlighted that some health sectors, such as pharmaceuticals (i.e. Vaccination), biotechnology, are generating increased interest by the committee. Thus, the risk of CFIUS review of a transaction related to supply chain issues is now higher than it was in the past.

While there has been an expansion of CFIUS' powers as a result of FIRRMA and the pandemic, does CFIUS have the resources to implement the policy it advocates?

Jason Chipman: One of the first things we talk to our clients about is whether or not CFIUS is interested in the transaction at issue. CFIUS' oversight and areas of expertise are expanding, but can the committee keep up? The FIRRMA Act expanded CFIUS' jurisdiction and, in turn, allocated new financial resources to the committee. New offices were created to monitor transactions that should have been reported. Likewise, existing offices were able to hire staff to facilitate their monitoring efforts. As a result, the likelihood that CFIUS will come in ex post and analyze the transaction and say that it should have been reported has, without a doubt, increased since 2018.

Do you think that the sale of a national "champion" that does not a priori fall under the purview of CFIUS can be blocked by the committee? Can the committee take on all cases, especially those that are political in nature?

Jason Chipman: CFIUS is run by career professionals. It can, though, be influenced by politics. Thus, it is necessary for an investor to think about possible political difficulties and not to be satisfied with purely legal aspects or a deal, especially for transactions involving national "champions". A deal involving a flagship company can be exposed to political pressure in several ways. A member of Congress or a state congress may criticize the operation in public, opponents (often competitors) may try to influence public opinion by criticizing CFIUS procedures and policies and, by extension, the occupant of the White House. The most obvious example is the planned investment by Dubai Ports World (DPW) in the Port of New York in 2006. The deal had to be transformed by the investors following public and insistent opposition, including in Congress, even though it had previously been approved by CFIUS.