

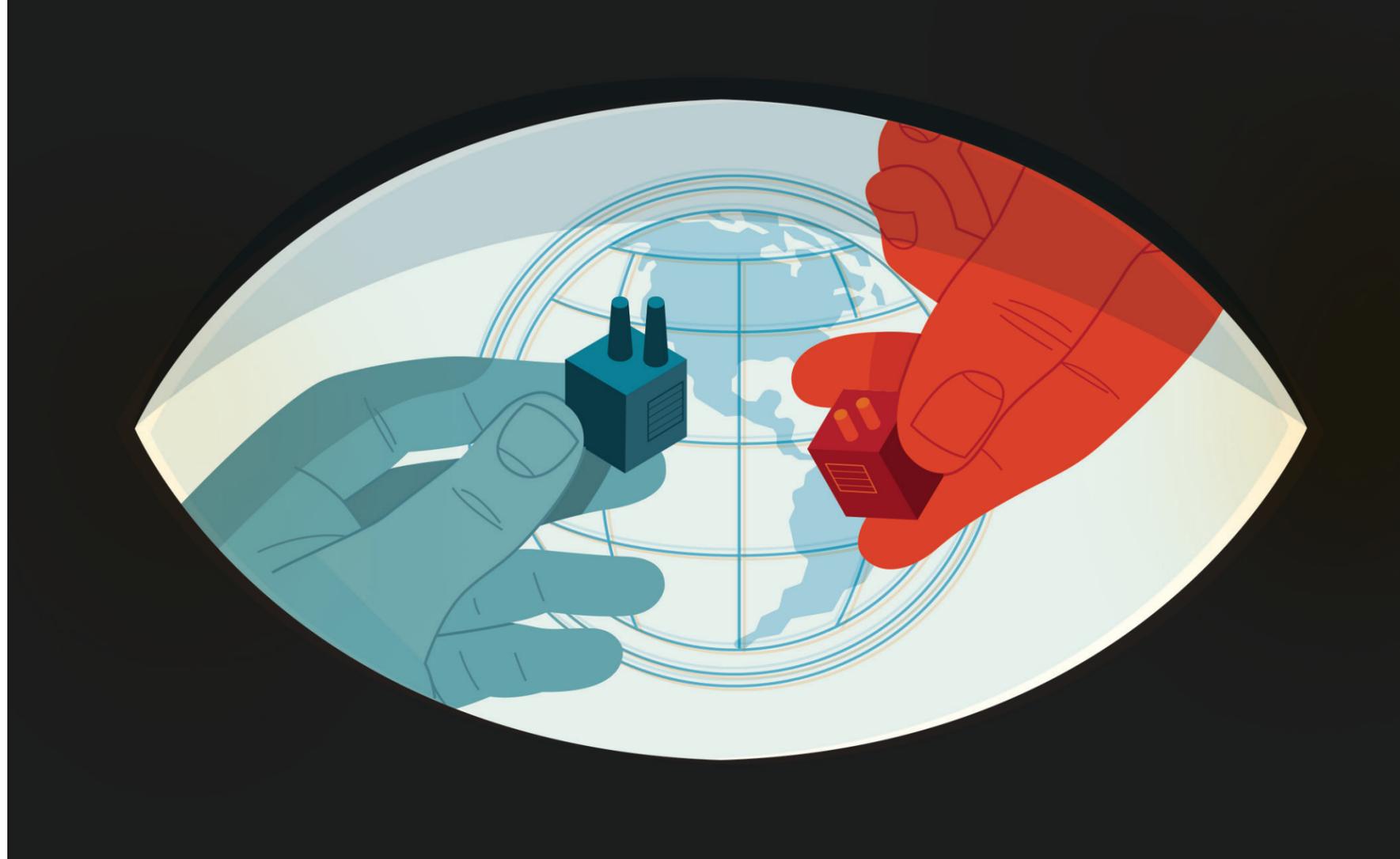
*The virus-induced crash certainly creates opportunities for foreign investors with strong cash positions to purchase US assets at historically low valuations.”*

JOE KELLY, Director, TD International LLC

FOR THIS MAGAZINE IN 2018, BRUNSWICK CEO Neal Wolin penned an essay about the Committee on Foreign Investment in the United States, or CFIUS. In composing it, Mr. Wolin drew from the knowledge and experience he'd gained during five years as Deputy Secretary of the US Treasury in the Obama Administration, during which time he was also Chair of CFIUS.

Such insight is valuable not only because CFIUS plays an important role in cross-border M&A, but because public knowledge about how this inter-agency committee of the US government works remains limited, for good reason: By law, information filed with CFIUS is subject to strong confidentiality requirements that prohibit disclosure to the public.

The mission of CFIUS is to review certain transactions involving foreign investment in the United States in order to determine the effect of such transactions on the national security of the United States. CFIUS can review, investigate, modify or recommend



that the president block any transaction that raises national security concerns that cannot be mitigated.

In the two years since Mr. Wolin published that essay, the landscape has changed considerably. Chinese acquisitions and investments in the US have dropped significantly. And in February of this year, nearly 18 months after the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) was enacted, marking the most significant changes to CFIUS in over a decade, the US Treasury issued the final set of regulations implementing FIRRMA.

The changes issued include: An expansion of the Committee's jurisdiction to include non-controlling investments in US businesses related to critical technology, specific assets of critical infrastructure and the maintenance or collection of personal data; an expansion of the Committee's jurisdiction to capture purchases, leases and concessions of real estate; a new category of "excepted investors" which will allow for some investors from certain countries to avoid the Committee's expanded jurisdiction; a new definition of what constitutes a US business; clarity on transactions that trigger mandatory filing requirements; and the introduction of "short form" declarations, instead of "long form" voluntary notices for parties involved in low risk transactions. There are other significant changes as well.

To obtain a sense of the current regulatory climate for foreign investment in the US, Brunswick's Alex Finnegan spoke with Eric Lebson, managing director and a founder of TD International LLC (TDI), the corporate intelligence firm, and Joe Kelly, a director of the firm. TDI, among other services, conducts due diligence on deals, foreign buyers and potential US government concerns, provides assessments of transactions and develops risk mitigation plans, works with parties involved in a transaction to advise on the cost and efficacy of specific risk mitigation plans that might be included in a national security agreement with the US government, and monitors mitigation agreements including reporting any concerns or violations to CFIUS. Both men previously worked for the government in national security capacities, Mr. Lebson at the Department of Defense and National Security Council in policy roles, and Mr. Kelly at the Department of Defense in intelligence roles. Mr. Finnegan is a Partner in the Washington, DC office of Brunswick.

**Has the pandemic altered your projections for foreign purchases of American assets in 2020?**

**KELLY:** The virus-induced crash certainly creates opportunities for foreign investors with a strong

# M&A BORDER GUARD

ERIC LEBSON and JOE KELLY, two veterans from the front lines of cross-border acquisitions, tell Brunswick's ALEX FINNEGAN what to expect from new rules governing the Committee on Foreign Investment in the US.

cash position to purchase US assets at historically low valuations. At such low prices, those investors may be much more willing to risk CFIUS review given the potential for a large return on the investment. From seller standpoint, some companies have used up cash reserves and are looking for sources of new capital – open to financing now whereas they would otherwise not be and otherwise strong companies saw their share values seesaw with market swings. Foreign investors with cash have an opportunity to buy into US companies at a time when their capital is sorely needed, but that creates an environment where some investments could be fundamentally good for both parties from a business perspective but pose national security risks. You can bet that the CFIUS agencies will be watching deal activity very closely during this period to highlight any that pose a presumptive concern.

#### For acquisitions involving potential national security concerns, is CFIUS any more or less a hurdle than before the pandemic?

**LEBSON:** FIRRMA broadened the aperture for CFIUS review of industries that hadn't been aware of their relevance to national security. Lifesciences was one such area and the pandemic will likely increase the level of CFIUS attention in that area. Companies engaged in pharmaceutical R&D, clinical trials, or medical research were already a concern from the perspective of personally identifiable information. But in the wake of COVID-19, we can see regulators viewing the work of those companies as being a national security concern related to biodefense and national infrastructure preparedness. At the same time, foreign entities might view involvement with US lifesciences companies as a good investment.

#### During his five years as CFIUS Chairman, Neal Wolin wrote in his Brunswick Review essay, there was a desire among the CFIUS staff to get to "Yes." Does that remain the case?

**KELLY:** You're dealing with a new cast of characters that are implementing a very different vision of trade in general. Neal's "Get to Yes" observation reflected the pursuit of a global trade agenda.

While I hesitate to say that "Get to Yes" is gone, there is very much a different lens through which all of these transactions are being viewed.

#### Why did proposed foreign acquisitions investigated by CFIUS jump 73 percent in 2017 and 69 percent in 2018?

**KELLY:** US behavior has been driven by a bipartisan



"WE WOULD EXPECT A SHIFT TOWARD A MORE NORMAL DEAL FLOW AS WE GET PERHAPS TO THE MIDPOINT OF 2020."

consensus around the perceived threat of China. No matter who won the election in 2016, this was going to be an issue. It was only a matter of intensity and style.

**LEBSON:** In the last year of the Obama Administration, the Department of Defense was already working on an assessment of a Chinese methodologies for leveraging commercial transactions in the United States to gain a national security advantage. The Department's Defense Innovation Unit Experimental had a serious concern about Chinese private-sector entities doing ostensibly normal M&A activity in the United States, and as a result, gaining access to information that would give them a national security advantage, either in terms of competitiveness on military technologies, or access to R&D, or personally identifiable information.

#### Will FIRRMA increase the percentage of proposed deals that are investigated?

**KELLY:** Under FIRRMA, the new numbers won't be comparable to the old. What the reform legislation did is create a category of "excepted" nations. There are three: the UK, Canada, and Australia—close intelligence-sharing allies. Deals from those countries will not be exactly "exempt," but face a much lighter burden in review. That's a very significant change compared to what was even in operation this past year, where if you were a British technology firm you still had to do a filing. That change will make comparisons with the past difficult. Also in terms of numbers, it's important to note that under the new regulations CFIUS will look at past deals much more than it did before, deals that went through without a CFIUS filing.

**LEBSON:** Retroactive reviews are an important issue. We've seen two recent examples where CFIUS has gone back and taken a look at closed transactions and prompted divestments related to them. The acquisition of GRINDR by a Chinese gaming company, Kunlun Group, was not submitted to CFIUS. It went through. It was public. It was published in newspapers. But CFIUS found out about it post-transaction and has told the company it must divest.

Another one involved a Chinese company that was in front of CFIUS regarding an unrelated transaction. They did not clear CFIUS approval and that transaction was abandoned. But then CFIUS went backwards, and took a look at other transactions that company had been involved in. CFIUS found that the company had purchased a building in New York that housed one of the police facilities responsible for the security of Trump Tower. CFIUS compelled the

company to divest of that purchase, that real estate transaction, which had closed over a year prior.

That's a significant case because it says that if you seek CFIUS approval and fail to get it, your earlier transactions could be exposed to scrutiny.

#### What role does your firm play in the process?

**LEBSON:** We provide what we call "red cell investigations," which are essentially investigations of the foreign party, even though ultimately that might be our client. We emulate what a government risk assessor would do. We want to present our investigation to our client and say, "This what they might pick up. Do you have explanations? Or can you help us put this into some context so that we can understand if this is going to be a problem, or whether this is just something that needs additional explanation?"

After the red cell investigation, the next step is looking at the transaction itself. We'll say, "This is a technology that is used in the following ways for national security." Or, "The facility that you're buying is right down the street from a military base, and there might be some concerns associated with that."

Then we put in place a risk-mitigation plan that can be submitted to CFIUS along with the application that says, "We believe we understand what may concern you. We understand you can't tell us because it's classified. But based on our understanding, we've put together this plan, and would the steps we're proposing be sufficient?"

We want to be really clear about something. If CFIUS has a national security concern, our goal isn't to circumvent that. The goal here is to have a transaction go through without causing any risk to national security.

**KELLY:** If the CFIUS staff doesn't believe the parties are sufficiently forthcoming, they can ask you to refile. If you get to a stage where they're willing to approve with mitigations, then the parties begin to enter a phase with the government where they negotiate the terms of a national security agreement that will lay out what the deal parties must do to gain approval. This will often include requesting an independent, third-party analyst to come in, evaluate the risks posed by the deal, and propose a mitigation plan.

If a third-party analyst is retained as part of a national security agreement, that independent third-party analyst is directed to do what the government says. So even though it was the deal party that hired the third-party analyst, that analyst has a fiduciary responsibility to satisfy the government.

Once that analyst produces a mitigation plan,



"THERE IS MUCH BROADER AWARENESS OF THE REGULATORY RISK POSED BY CFIUS THAN EVER."

then typically there is a mandate as part of the agreement that you will hire a different independent third-party monitor to execute the mitigation and monitoring plan.

That's a process that adds significant deal costs. What may have looked like a good, profitable transaction, now may look a little less attractive. This is where our expertise comes in, understanding the real nature of the government concern. What is the minimum threshold at which you feel you have satisfied the government's concerns? You're trying to simply identify a sufficiency threshold, and hopefully that doesn't wind up costing too much for the deal parties.

One often-overlooked important element is communication—helping explain who the foreign party is, introducing the party to an American audience that might have concerns. That should all be integrated into a legal strategy. But I would be very careful to choose a communications firm with CFIUS expertise. Communications, risk mitigation, and legal assistance are the three mechanisms for helping to steer a transaction through the CFIUS regulatory process and address any legitimate concerns that CFIUS may have.

## THE WOONG OF US FIRMS, BY NATION

### Covered Transactions by Acquirer Home Country or Geographic Economy, 2015-2017

Country/Economy	2015	2016	2017	total
Australia	4	4	5	13
Canada	22	22	22	66
China	29	54	60	143
Japan	13	13	20	46

## THE RISING WORKLOAD OF CFIUS

### Notice, Withdrawals and Presidential Decisions 2014-2018

Year	Number of Notices	Number of Investigations	Presidential Decisions	Total Notices Withdrawn
2014	147	51	0	12
2015	143	66	0	13
2016	172	79	1	27
2017	237	172	1	74
2018	229	159	1	66

### Has demand for CFIUS-related advice risen in recent years?

**KELLY:** The reform regulations created an interesting pause. I was speaking with a CFIUS bar attorney just yesterday. I asked how many filings his firm had for 2019. The answer—basically the same as 2018—was a bit of a surprise. People expected there would be a higher number of filings once the reform legislation had passed—that was in 2018. But it wasn't implemented until February of 2020, so uncertainty lingers, and there seems to have been a longer pause than people were anticipating.

**LEBSON:** Our interpretation is that there is much broader awareness of the regulatory risk that is posed by CFIUS than there ever has been. And the pause that Joe's talking about is a function of waiting for clarity regarding how the regulations were going to be promulgated.

Now that implementation has happened, we're anticipating that there'll probably be an uptick in transactions. We're anticipating that there will be more transactions related to China. But also, because of the broader understanding of the regulatory responsibilities and risks associated with CFIUS, we believe there will be an uptick in submission from parties not related to China.

**KELLY:** One key point of the reform legislation is aimed at the venture capital community, and in particular, the startup community, where a lot of Chinese money was coming in. There was great concern that foreign firms, particularly the Chinese, were gaining access to technology at very early stages that wouldn't require a review.

So, the government created the short-form declaration process. Recognizing that a startup doesn't have the bandwidth or resources to go through a full-scope CFIUS review, they came up with this compromise filing that says, "Take a look at what we're proposing. Do you see any issues around who we are, who our investors are, and the level of involvement?"

We would have thought that there would be a large number of these short-form filings last year. But interestingly, when we talk to CFIUS bar attorneys, we hear that the number of transactions last year in the category of short-form declarations was much, much smaller than they had anticipated. I haven't heard an exact number from anyone, but it was below 200, maybe in the low 100s. They were anticipating something more on the order of 300. As implementation takes hold in 2020, that's going to be a key area to watch.



**"THE PANDEMIC WILL LIKELY INCREASE THE LEVEL OF CFIUS ATTENTION IN LIFESCIENCES."**

### Your sense is that there may be a number of potential buyers on the sidelines?

**KELLY:** That's what we suspect. We attribute it to relative uncertainty, combined with other economic factors, such as volatility and a general sense of companies retooling where they're at. Certainly, with some of the flameouts on a couple of high-profile IPOs, there are a lot of people in that community that are re-thinking their broader strategy. But this is an additional reason to pause and be careful. We would expect a shift toward a more normal deal flow as we get perhaps to the midpoint of 2020.

**LEBSON:** We also believe that we're going to start to see companies and the law firms advising them to emphasize proactive action. Rather than rolling the dice and seeing whether CFIUS has a problem with the transaction, they'll consider how to tell their story in a way that will adequately address any concerns the CFIUS staff might have.

We believe that as the awareness increases about CFIUS jurisdiction and risk associated with transactions before CFIUS, sophisticated parties will start to say, "Instead of submitting this to CFIUS, and asking them to review the deal, why don't we go ahead and do a risk assessment, and come up with a risk-mitigation plan, so that when we make our submission, they can see that we understand their concerns and we're prepared to do productive things to help manage those, even after the transaction closes."

### Does the presidential election create uncertainty for potential foreign investments?

**LEBSON:** The political leadership in charge of the government entities that are members of CFIUS changes with administrations. And that sets a type of tone. But the CFIUS staff are career civil servants who work with consistency regardless of who's in the White House.

We have not seen CFIUS used as a significant political tool in the US-China bilateral relationship in trade disputes. CFIUS is a different animal. It's very deal focused. It isn't dealing with large groups of entities, individuals, and corporations like a sanction would. And it isn't dealing with broad categories of goods and services like tariffs would be involved in.

If we reach a trade deal with China in advance of the election, that may open the door to increased US-China bilateral trade. And M&A transactions go along with that. So, we could see an uptick in transactions if there's a trade deal with China. ♦

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