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The new roadblock to cross-border M&A in an ever-more globalised world

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As if it was not already tough enough to get a complex cross-border deal done. Differences in valuation and pricing, legal pitfalls associated with the targeted business, financing and the conditions thereof as well as merger control, are only a few examples of the hurdles of complexity and uncertainty dealmakers face in a transaction. But now there is another major roadblock: Foreign Investment Control 2.0.

The most prominent and influential of these regimes is without a doubt the Committee on Foreign Investment in the United States (CFIUS). Even if you think that a deal only has limited nexus to the US and the business in question at first sight does not appear to be sensitive, you could end up with CFIUS having a major impact on the structure, timing and ultimate success of the transaction. While this trend of stricter scrutiny in the US seems to have been spurred under the new administration's 'America First' policymaking and more combative approach to international trade, other countries such as Germany have recently also tightened their foreign investment rules

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out of fear of foreign access to, and control of, sensitive technologies and infrastructure. Moreover, the EU is currently looking into harmonising those foreign investment rules, although it is a tough balancing act between pan-European and EU member states' security interests vs. attracting foreign investments.

The last 12 to 18 months have seen a significant uptick in US foreign investment control, having resulted in more cases before CFIUS, more refusals of transactions, more withdraw/refile activity, longer review processes and, thus, more complexity and uncertainty. Confronted with this trend, M&A practitioners need to acknowledge this additional layer of challenges and risks and re-equip their toolboxes for successful dealmaking accordingly.

CFIUS: scope, process and risks

Among the foreign investment control authorities at a global level, CFIUS has probably one of the broadest and most discretionary scopes. As an interagency committee that is made up of members of several US departments and chaired by the treasury secretary, it is authorised to review the national security implications of transactions

that could result in control of a US business by a foreign person ('covered transactions'). CFIUS is authorised to block covered transactions or impose measures to mitigate any threats to US national security. In the case of the blockage of the takeover of Qualcomm by Singaporean Broadcom, what would have been the largest ever takeover in the technology sector became the first time that CFIUS intervened on a transaction before it had been finalised. And, as other recent cases such as Biotest/Creat have shown, not only US technology companies qualify for CFIUS review, but any US business (not necessarily in the form of a shareholding) as well as any personal data of US citizens collected by such business. 'US business', therefore, can encompass foreign-to-foreign deals in which the target has one or more US subsidiaries or significant US assets or operations, the formation of joint ventures in which one party contributes an existing US business, and deals involving long-term leases of US assets that operate as de facto transfers of US businesses.

The CFIUS review process starts when the parties to a transaction submit a voluntary notice, which

is a fairly detailed and voluminous document, to CFIUS or CFIUS otherwise becomes aware of a covered transaction. However, in practice, it is common that the parties to a transaction first submit a draft notice before the official 30-day review period begins to give CFIUS and the parties involved the opportunity to resolve any issues or concerns before the clock starts running. This document should be filed immediately following the signing of a transaction and thus, already be prepared well ahead of signing.

Following the unofficial pre-filing phase, the actual review process includes a 30-day review of the notified transaction followed by a separate 45-day investigation period if the review is not completed within the review period. While the official total term of the combined review and investigation periods is 75 days, CFIUS often asks the parties to withdraw and refile the notice towards the end of the 75-day period, thereby restarting the clock and turning what is officially structured to be a two-and-a-half month process into one that can take from six to nine months. Finally, the 45-day investigation period could be



followed by another 15-day period for the review by the US president, who can ultimately prohibit or suspend the deal.

Therefore, the duration of the CFIUS review is difficult to predict. As a consequence, in a contested auction situation, for example, certain non-US bidders can, both from a timing and a deal certainty perspective, be at a huge disadvantage when subject to CFIUS review, which they often can only compensate by 'overpaying' for the business.

Not filing at all, however, seems to become less and less of an option when in doubt, as CFIUS may request the parties to file the transaction for review even years after closing. This could be a huge risk to take, and would be an organisational and financial nightmare should the deal be retroactively prohibited.

Things to keep in mind on the buy-side

For a potential foreign buyer of a US business, it will be essential to examine whether the transaction is subject to CFIUS, due to the target, its business, assets or locations, or due to the buyer and its shareholder structure or global business activities. The more sensitive the target's

business assets or US portions thereof are – such as high-tech or telecommunications or personal data of customers – the more likely it is that CFIUS will want to take a look at the transaction. The closer the buyer's ties to China or the Chinese government – whether as shareholder, through former government officials in management or through government contracts – the more likely it is that CFIUS wants to know about this. This, however, also applies to other countries for which the US has put embargos in place. If the target has sites or assets located close to US military facilities, this might pose a problem to CFIUS as well.

The more open, proactive and forthcoming the buyer, the greater the likelihood that it can instill comfort in CFIUS with respect to the contemplated transaction. In addition, a foreign buyer could consider offering to the seller a reverse break fee and obtain a related CFIUS reverse break fee insurance. This type of insurance is said to enable foreign buyers to offer a reverse break fee which could make their offer competitive (in terms of deal certainty) with offers from US bidders that do not face the same CFIUS risk.

In the case of a public takeover bid, the bidder should mind the long-stop date and other timing issues in light of the unpredictability and often substantially expanded timelines. In addition to the customary regulatory covenants and closing conditions, potential remedies and mitigation strategies should be considered in advance. Especially with regard to foreign-to-foreign transactions, CFIUS due diligence will also need to take into account whether the demerger or divestment of a sensitive US business is technically feasible and economically acceptable.

Things to keep in mind on the sell-side

Sellers will also need to assess and minimise possible deal risks as part of the structuring of the transaction and the bidder selection process by looking favourably at those bidders which pose the least CFIUS risk. This could result in preferring a US buyer or another foreign buyer with a proven CFIUS track record or a buyer which would be willing to implement certain mitigation measures over those whose CFIUS clearance is not clear at the outset. On the other hand, when putting a lot of emphasis on deal certainty, this



could adversely affect the ultimate purchase price that the seller could achieve. Conversely to the buy-side situation described above, the seller that would be willing to consider a bidder questionable from a CFIUS perspective should request a reverse break fee. When developing the deal structure and timeline, the seller should keep the unpredictability of the CFIUS review process in mind. In order to ensure a smooth process, the seller should also get a good understanding of the buyer's business activities, management and shareholder base; all these factors will

be taken into account by CFIUS when reviewing the deal.

Outlook

The good news is that foreign investment control in general, and CFIUS in particular, have received more attention by dealmakers and business press around the globe, which should lead to parties being better prepared. The bad news, however, is that foreign investment control rules and regulations, in particular CFIUS, are getting tighter and tighter. CFIUS has undergone dramatic change over the past one

or two years, but the changes will be even more dramatic with the new CFIUS reform legislation introduced by Congress last November. Due to the bipartisan support of the proposed legislation, it is expected to be enacted as early as this year. As a result, the scope of CFIUS will be even broader, the number of cases and with them the number of refusals will continue to increase, and the review process will become longer once more. Unfortunately, there are no signs that cross-border dealmaking will become less burdensome in the short term. ■