

March 15, 2023

CFIUS AND GERMAN FDI REVIEW

A Comparative Discussion on Practical Implications

GIBSON DUNN



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02 CFIUS Recent Developments

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Panelists



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Please note that the enclosed materials have been prepared for general informational purposes only and are not intended as legal advice.

CLE Credit

- Approved for 1 hour General PP Credit
- CLE credit form must be submitted by **Wednesday, March 22nd**
- Form link: https://gibsondunn.qualtrics.com/jfe/form/SV_3kMTHd08yzmNfp4
- **Please direct all questions regarding MCLE to CLE@gibsondunn.com.**

CFIUS

Overview

01

The Committee on Foreign Investment in the United States “CFIUS”

- **CFIUS** is an inter-agency committee authorized to review the national security implications of foreign direct investment in the United States.
- CFIUS is authorized to **block** transactions that fall within its jurisdiction or **impose measures to mitigate** any threats to U.S. national security.
- The Committee was established in 1975 by executive order. The 1988 **Exon-Florio Amendment to section 721 of the Defense Production Act of 1950** provided authority to the President to suspend or prohibit certain transactions. The Committee is further governed by Executive Order 11858, as amended, and maintains regulations at 31 C.F.R. Parts 800-802.
- Historically, CFIUS only had jurisdiction to review, block, or impose mitigation measures on transactions that could result in a foreign person acquiring **control** of a U.S. business.
- In 2018, the Foreign Investment Risk Review and Modernization Act (“**FIRRMA**”) expanded the categories of covered transactions, updated its review process, and made CFIUS review mandatory in certain cases.
- FIRRMA expanded the scope of transactions subject to the Committee’s review to include certain foreign non-controlling (equity) investments in U.S. businesses that deal with **critical technology, critical infrastructure, or the sensitive personal data** of U.S. citizens (“**TID**” businesses).

The Committee consists of Nine Permanent Members

CFIUS Member Agencies



Commerce



Defense



Energy



Homeland
Security



Chair, Treasury



USTR



OSTP



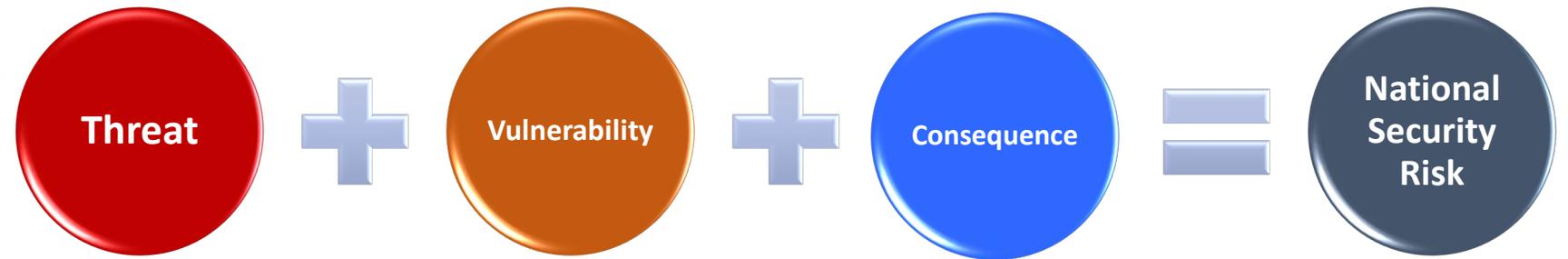
State



Justice

In addition, there are five Observer Agencies—Council of Economic Advisors, Homeland Security Council, National Economic Council, National Security Council, and Office of Management and Budget. Other agencies may be added for specific reviews.

National Security Risk Assessment: The Core of the CFIUS Analysis



Threat: Intent and capabilities of a foreign person to take action to impair national security

Vulnerability: Extent to which the nature, location, or relationships of the U.S. business presents susceptibility to impairment of national security

Consequences: Effect on national security from exploitation of vulnerabilities

- The CFIUS regulations specifically address the national security risk assessment that the Committee undertakes
- In order to provide additional information to evaluate the national security risk, the **National Intelligence Council** produces a classified **National Security Threat Assessment** (“NSTA”) for transactions under CFIUS review
 - Information asymmetry as the parties to the CFIUS filings are not “read into” the classified assessment and must instead use their knowledge of the parties, the transaction, broader industry trends, and underlying national security policy to advocate in support of the transaction

Timeline for a CFIUS Filing (Full Notice)

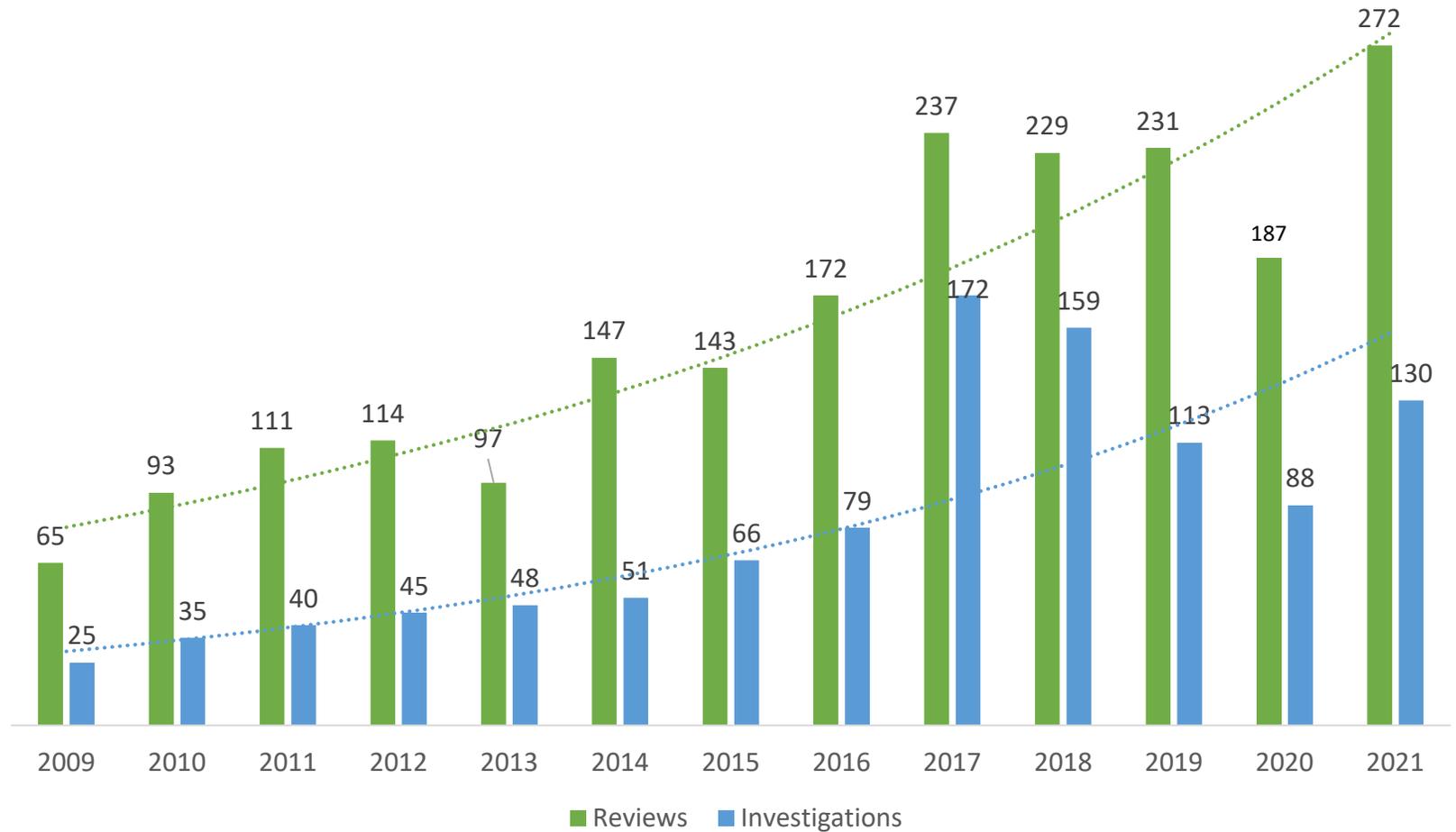
- Committee typically takes a week to formally accept a CFIUS filing
- CFIUS issues a letter designating lead agency and starts clock

- CFIUS may continue review with a 45-day investigation period
- CFIUS may ask questions, which require a response in 3 business days
- CFIUS may extend 15 days for “extenuating circumstances” or may request the parties withdraw and refile

Submit Draft	Submit Notice	Initial Review	Investigation	Presidential Review
<ul style="list-style-type: none"> • Committee typically takes 1-2 weeks to review draft filings • Not required to submit draft filings, but routine practice • Typically takes 3-4 weeks to collect the necessary information to prepare the draft filing 		<ul style="list-style-type: none"> • CFIUS undertakes an initial 45-day review period • CFIUS may ask questions, which require a response in 3 business days 		<ul style="list-style-type: none"> • While virtually all reviews conclude at the investigation phase, the President has the authority to review and block transactions during a 15-day period following the investigation phase • No presidential decisions were made in 2021, for the first time since 2016

Emerging Trends: Increasing Use of CFIUS

CFIUS Reviews and Investigations by Year



CFIUS

Recent Developments

02

CFIUS E.O.: Specific Factors for Review

- On September 16, 2022, President Biden issued an executive order directing CFIUS to specifically consider 5 factors in the Committee's national security reviews:
 - **The resilience of critical U.S. supply chains** that may have national security implications, including those outside of the defense industrial base;
 - **U.S. technological leadership** in areas affecting U.S. national security, including but not limited to microelectronics, artificial intelligence, biotechnology and biomanufacturing, quantum computing, advanced clean energy, and climate adaptation technologies;
 - **Aggregate industry investment trends that may have consequences** for a given transaction's impact on U.S. national security;
 - **Cybersecurity risks** that threaten to impair national security; and
 - Risks to **U.S. persons' sensitive data**.
- This was the first-ever E.O. directing CFIUS to consider specific factors—and appears to highlight the Administration's efforts to ensure certain substantive factors are considered in the national security review as well as to increase transparency in the CFIUS review process
- The E.O. doesn't alter CFIUS processes or legal jurisdiction, but rather elaborates on certain existing factors that the Committee is mandated by statute to consider

CFIUS

Enforcement & Penalty Guidelines

- Published on October 20, 2022 by Paul Rosen, Assistant Secretary of the Treasury for Investment Security
- Guidelines do not appear to track changes in statutory or regulatory authority, but rather formalize the enforcement and penalty processes
- Release of the Guidelines coincides with increased hiring of monitoring and enforcement staff, as well as statements by the Committee regarding their increased focus on non-notified transactions
- 4 Key Components:
 1. Identifies **three types of violations** of CFIUS's regulations and requirements: (i) failure to file; (ii) non-compliance with mitigation; and (iii) material misstatement, omission, or false certification;
 2. Describes the **process for imposing penalties** the Committee will generally follow;
 3. Formally introduces the concept of a **voluntary disclosure**; and
 4. Discusses **aggravating and mitigating factors** that inform the enforcement response and penalty calculation.
- Clarifies **sources of CFIUS enforcement information** as: (i) requests for information; (ii) tips; (iii) subpoenas; and (iv) voluntary disclosures
- Reinforces **CFIUS penalty authority** for failure to file a mandatory declaration or material violation of mitigation agreement of \$250,000 or the value of the transaction, whichever is larger

Key Features of the National Security Strategy

“ Russia and the PRC pose different challenges. Russia poses an immediate threat to the free and open international system, recklessly flouting the basic laws of the international order today, as its brutal war of aggression against Ukraine has shown. The PRC, by contrast, is the only competitor with both the intent to reshape the international order and, increasingly, the economic, diplomatic, military, and technological power to advance that objective.

National Security Strategy

- On October 12, 2022, the Biden Administration released its long-awaited National Security Strategy
- Two principal challenges identified:
 - **Geopolitical competition** (e.g. China, Russia) and **transnational challenges** (e.g. climate change, renewable energy, COVID-19, food insecurity, supply chains)
- Introduces a **modern industrial and innovation strategy**
- Three strategic priorities:
 - **Domestic investment** in key technology areas,
 - **Strengthening alliances and building coalitions**, and
 - Influence **global rules** on emerging technology and trade
- Significantly, the Biden Administration has **distinguished** the threats posed by Russia and China, with Russia seen as a threat to **regional stability** while China is viewed as the **pacing challenge**

National Security Policy Shapes The CFIUS Landscape



“We are identifying and investing in key areas where private industry, on its own, has not mobilized to protect our core economic and national security interests... We are securing our **critical infrastructure**, advancing foundational **cybersecurity** for critical sectors,... working with the private sector to improve **security defenses in technology products**... and securing our **supply chains**.”

“We are countering intellectual property theft, forced technology transfer, and other attempts to degrade our technological advantages by **enhancing investment screening** [and] export controls...”

National Security Strategy
Released 10.12.22

Impact of CFIUS on Deal Certainty

03

CFIUS

Impact: Failure to Close

As illustrated by three recent examples, CFIUS review can cause deals to fall apart if national security risks cannot be sufficiently mitigated

- In September, 2022, **Snapdragon Chemistry** announced that its acquisition by **Asymchem** would not be proceeding, due to an inability to agree to mitigation terms that would satisfy CFIUS.
 - Snapdragon is a U.S. based drug services firm, while Asymchem is a Chinese pharmaceutical research company.
 - CFIUS involvement in this transaction indicates the potential for increased scrutiny of **pharmaceutical-related technology**.
- **Viston United Swiss** withdrew its takeover bid of **Petroteq Energy** after CFIUS undertook an investigation and rejected a **voluntary notice** filed by the companies.
 - Viston is a Swiss company investing in fostering innovative technologies for renewable energy and environmental protection. U.S.-based Petroteq develops oil-extraction technologies.
- **Magnachip** and **Wise Road Capital** were forced to terminate their previously announced merger when they were unable to obtain CFIUS's approval, despite months of effort.
 - Wise Road is a Chinese private equity firm and Magnachip is a South-Korea based semiconductor company.
 - A vast majority of Magnachip's operations take place outside of the United States, but Magnachip's incorporation in Delaware met the low threshold for **CFIUS jurisdiction**.
 - This was a **non-notified transaction**, but CFIUS requested that the parties submit a filing shortly after the transaction was announced.

CFIUS

Impact: Divestment

CFIUS review can also result in divestment of ownership if the deal has already been completed, potentially resulting in total loss of an investment

- **Borqs Technologies** divested investment in **Holu Hou Energy LLC** after receiving a letter from CFIUS requiring the company to fully divest its ownership interests and rights in HHE.
 - Borqs is a China-based corporation, and HHE is a U.S. solar energy storage supplier.
 - The national security risk at issue related to the HHE solar energy storage system and EnergyShare technology for Multi-Dwelling Residential Units being deemed a **critical technology**.
 - Borqs acquired 51% ownership of HHE in October 2021, and the CFIUS letter requiring divestment was received in December 2022.

CFIUS Impact: Prolonged uncertainty

CFIUS review can take months, causing prolonged deal uncertainty

- **TikTok** has been under investigation by, and in negotiations with, CFIUS since 2019, with ongoing uncertainty about the final determination regarding Chinese corporation ByteDance's ownership of TikTok.
 - The national security risk is twofold: 1) collecting **personal data** of TikTok users in the United States and 2) using TikTok for **ensorship, disinformation, and propaganda** campaigns targeting American society.
 - Most recently, TikTok has put forward a proposal to wall off American user data in a separate corporate entity, shielding it from TikTok's Chinese owners.
 - However, TikTok's presence in the U.S. continues to be a political matter, with various federal agencies and members of Congress pushing for total divestment or a ban.

EU FDI Overview

04

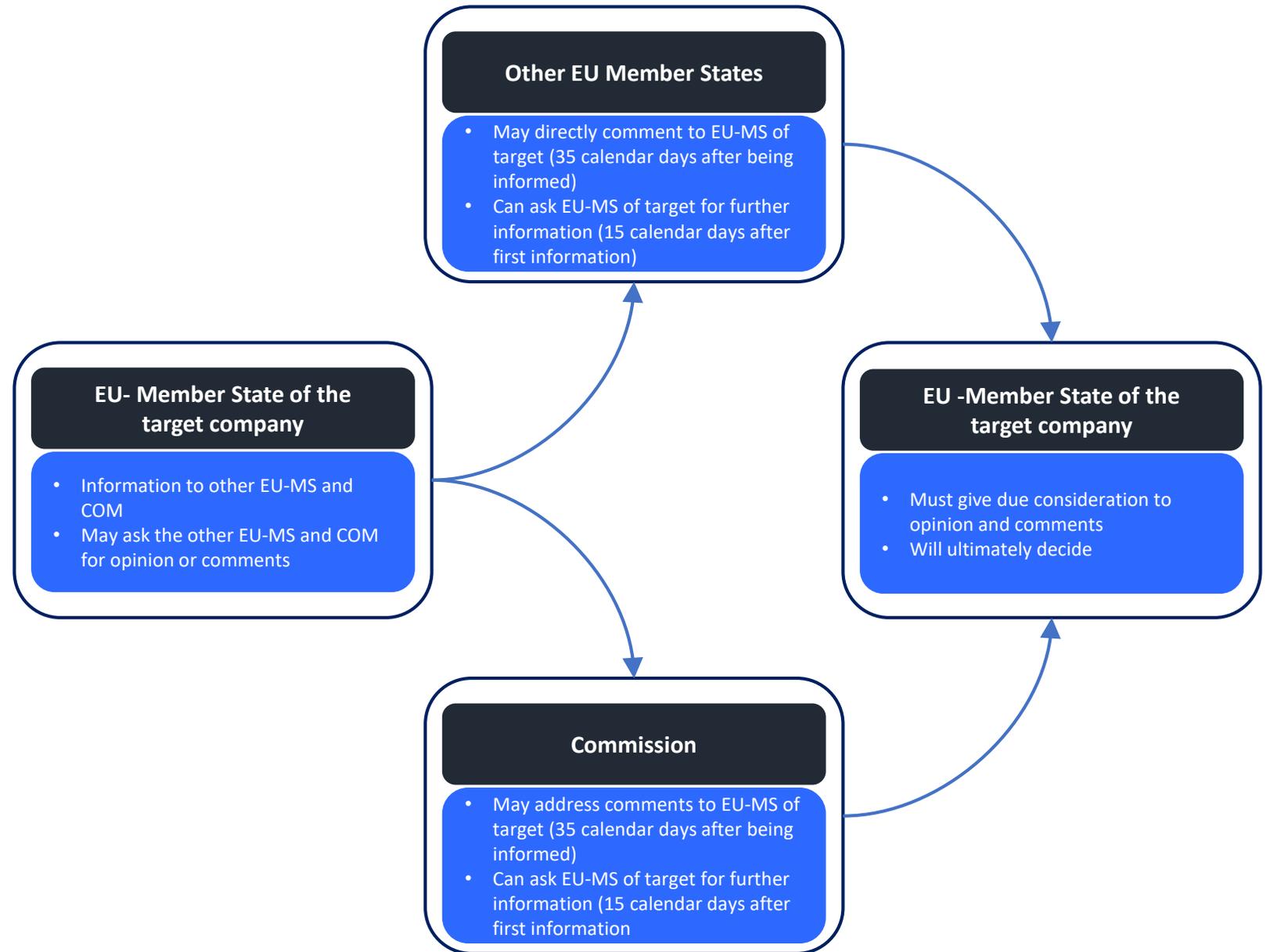
EU Coordination Mechanism

- The EU set up an elaborate framework for the coordination of foreign direct investment (FDI) screening in the EU. It has been applied since October 2020.
- This FDI Regulation is the first to give the Commission general powers to review private transactions.
- It does not create an EU-level FDI screening mechanism but sets out minimum requirements for EU Member States' FDI screening mechanisms and a mechanism for coordinating FDI reviews among member states.
- The Commission strongly encourages the implementation of national FDI screening mechanisms, and at least 24 Member States have or are in the process of establishing one.



EU Cooperation: An Illustration

Consultation Mechanism
pursuant to the FDI
Screening Regulation
(Art. 6 of the FDI Regulation)



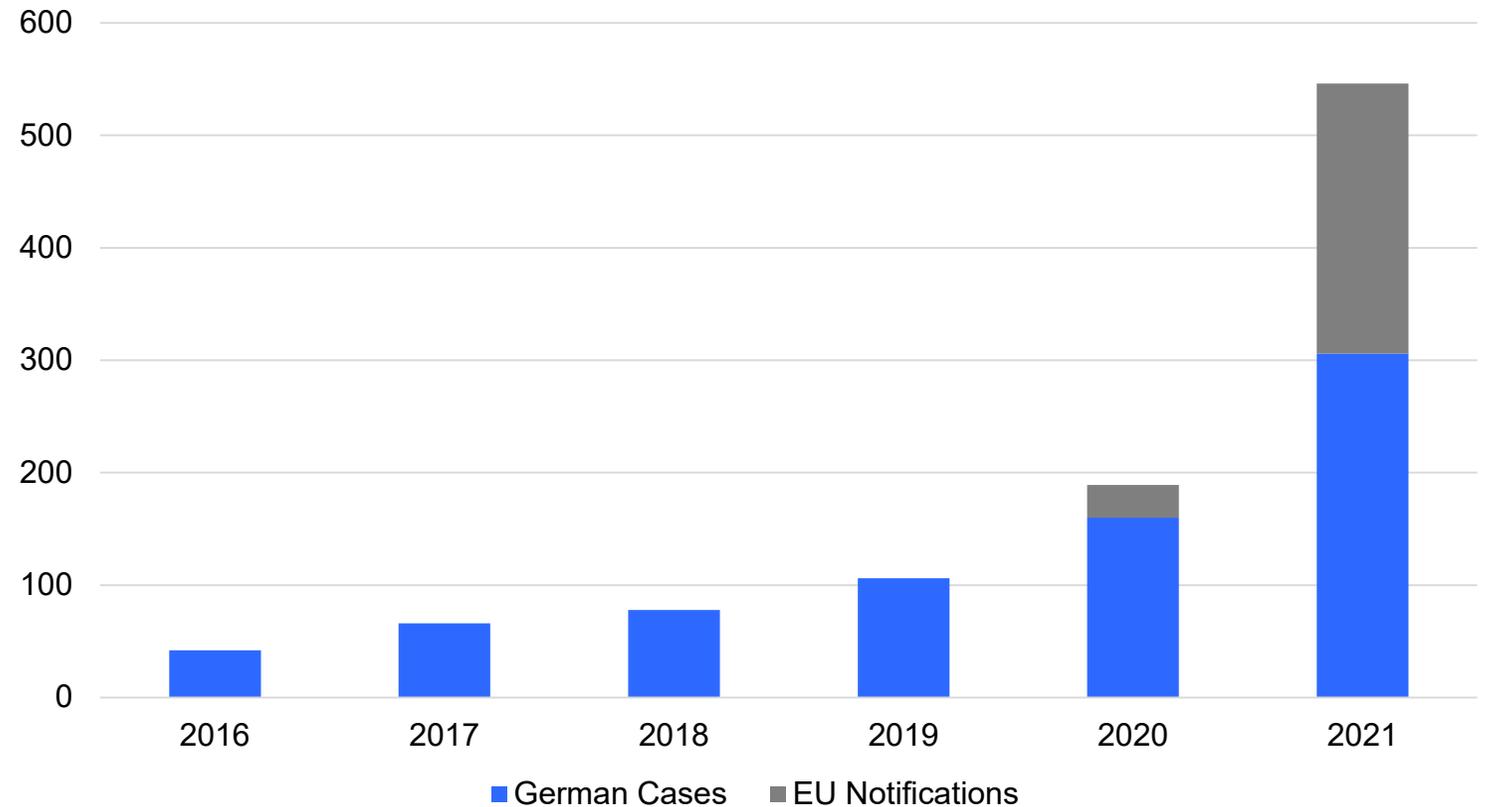
German FDI Overview

05

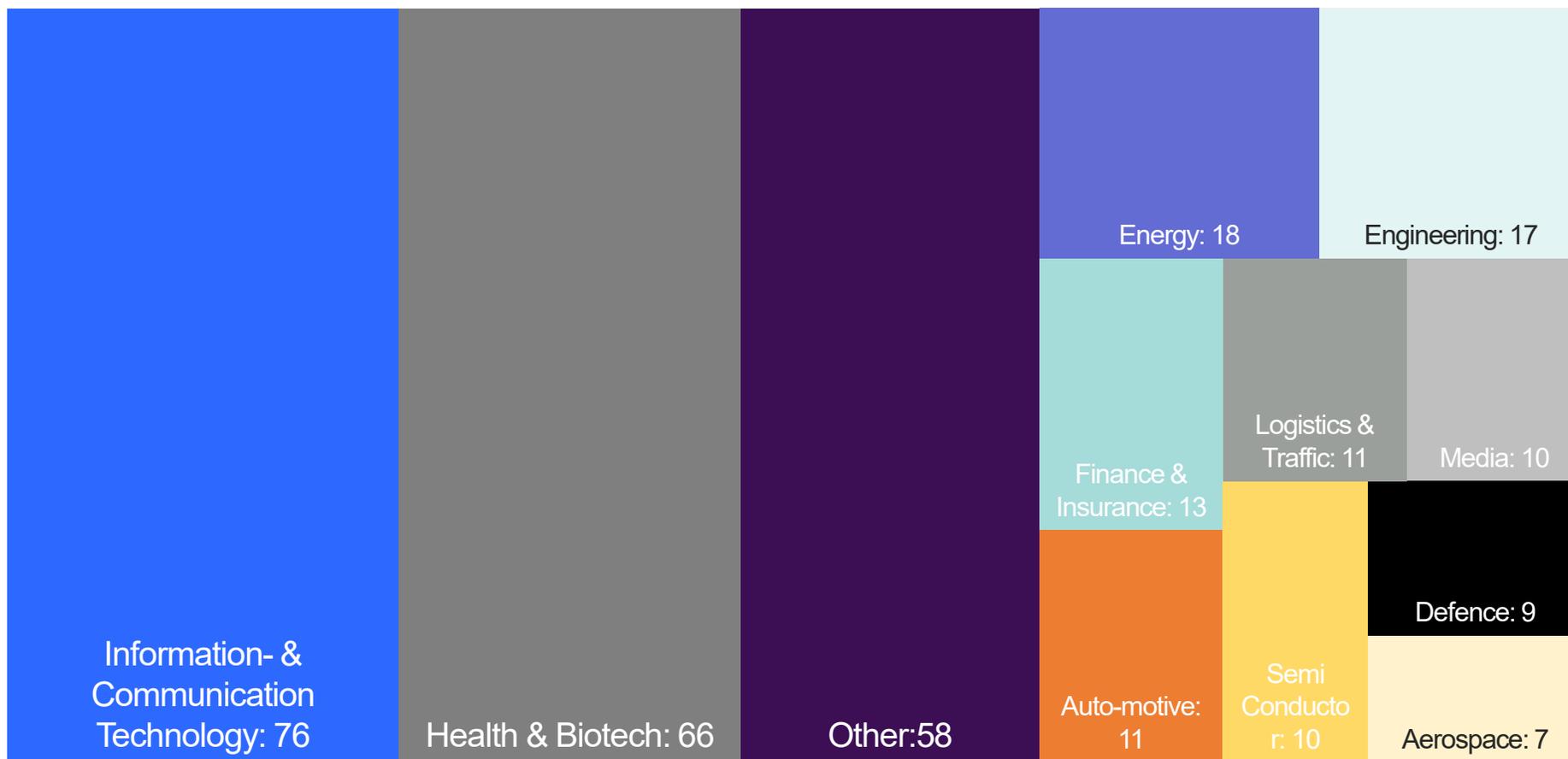
FDI Screening: From Niche to Standard

*Combined with EU cases,
German Federal
Government screened 546
cases in 2021*

Development in Screened Cases Germany

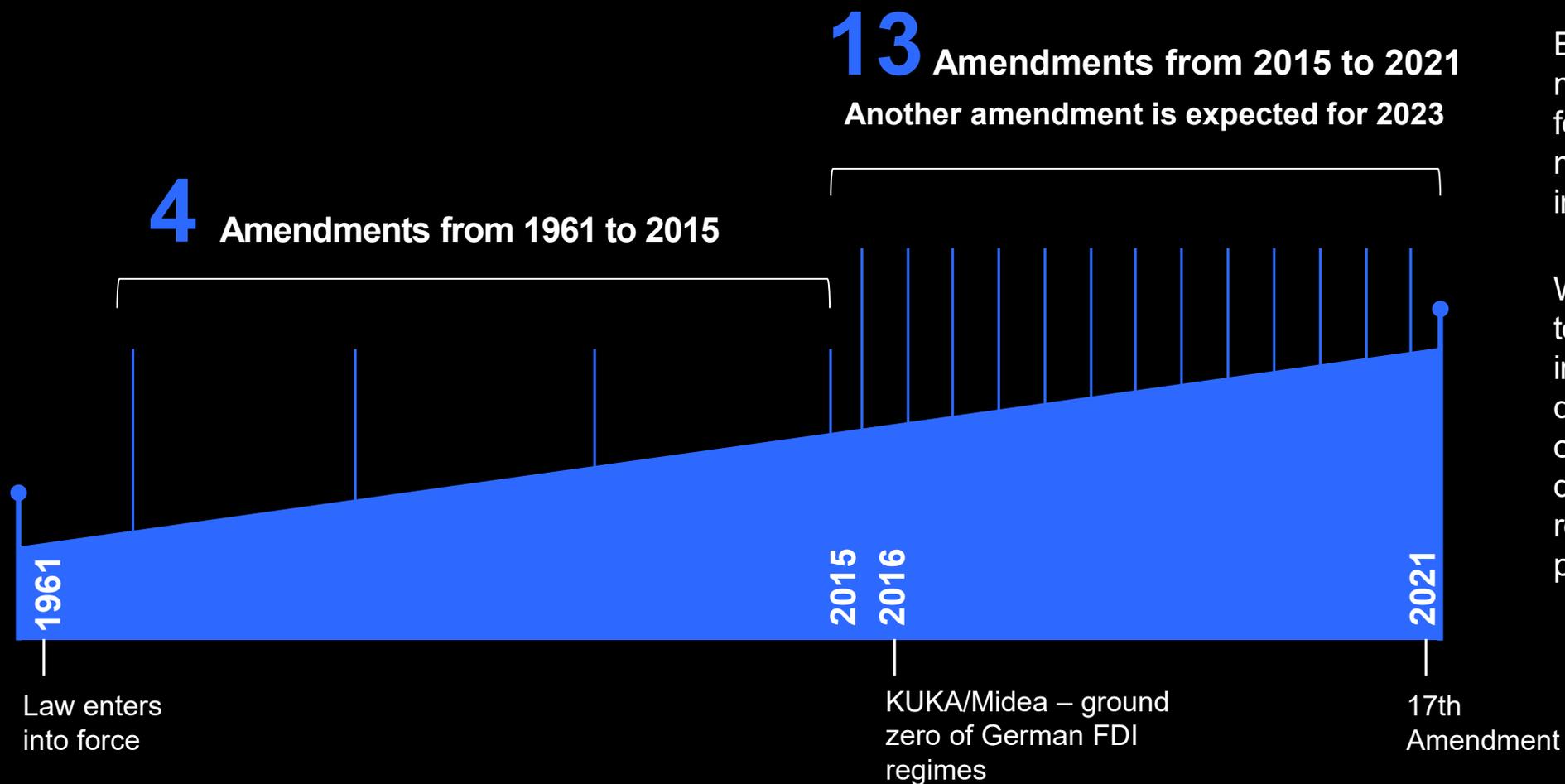


Sectors of German Target Companies



This slide refers only to the 306 National (German) FDI Screening Cases in 2021

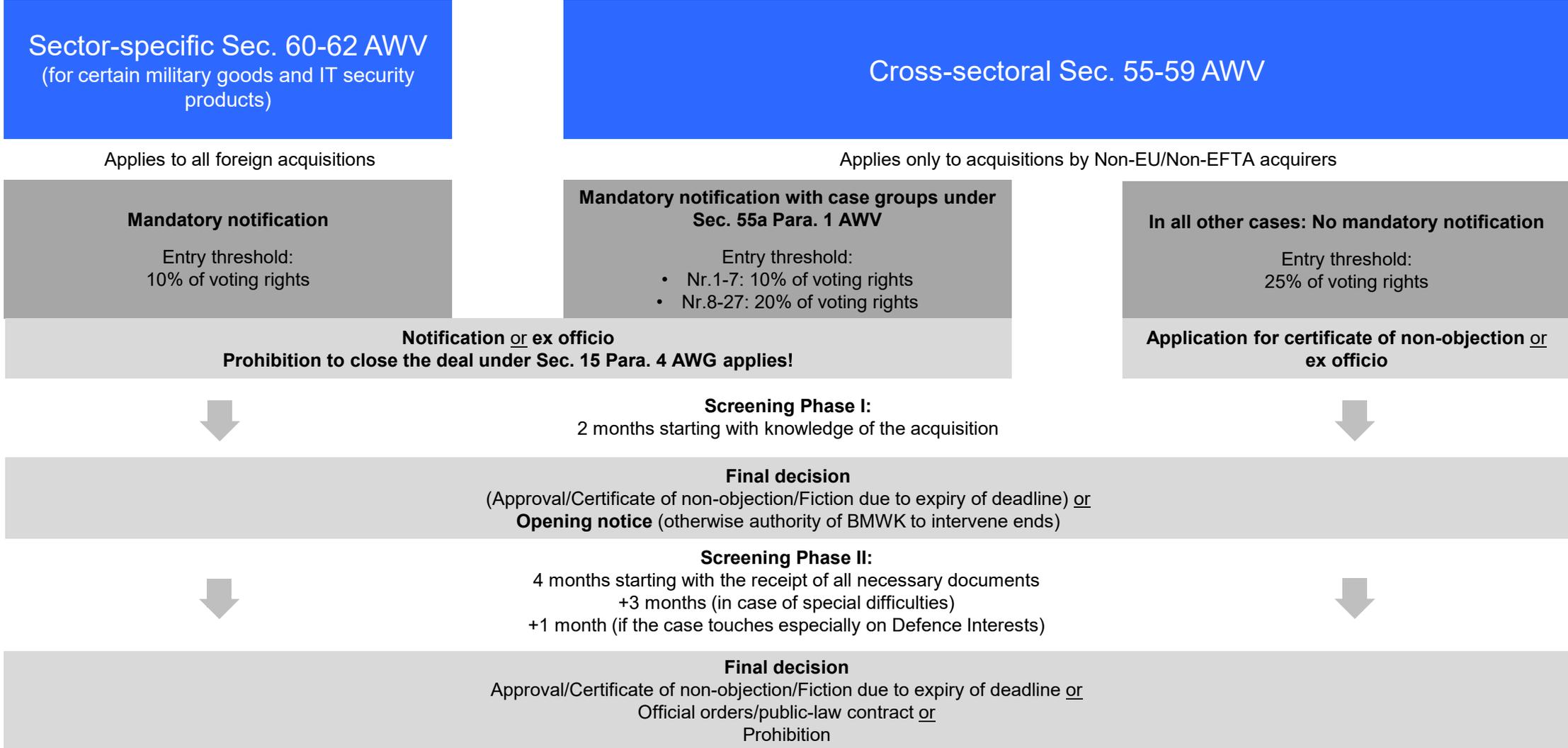
60 Years Of FDI Regulation In Germany



Every amendment means more powers for the federal government and more rigorous criteria for investigations

We see a trend of scrutiny towards foreign investments increasing – now, even if the deal does not have any obvious national security dimensions, the potential for a review should be considered pre-transaction.

Process of FDI Screening Germany



German FDI

Recent Developments

06

Recent Developments on German FDI Laws

- Substantive test **lowered**
- Lowering investment control **threshold**
- **Expand foreign investment scrutiny:** vaccines, drugs, PPE, and other medical goods; various critical sectors have been added
- **Add-on acquisitions** explicitly covered
- Exception group internal organizations introduced (but **very narrow**)

Regulatory Deal Hurdles Are More Politicized Than Ever

Suspicion has increased

Governments are increasingly skeptical of foreign investments and apply broad definitions of national security.

Governments will protect their interests and seek the limits of their ambitions

They will deploy their power to act or not vis-à-vis transactions, competition, and market dynamics

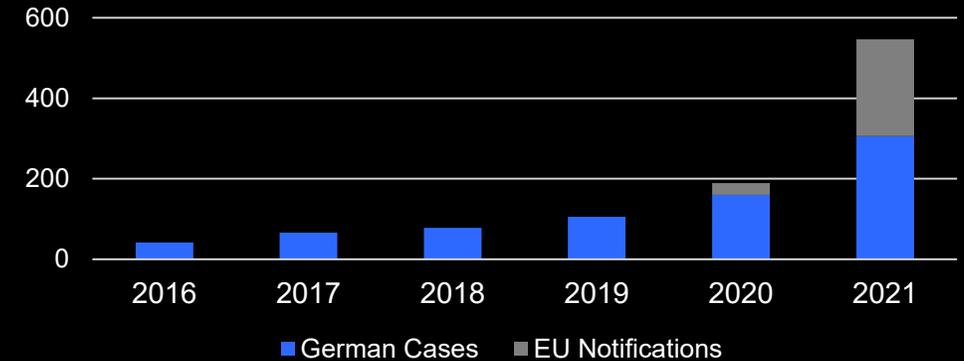
Protection of national strategic interests, e.g., digital and green transitions as key priorities

Key policy considerations are increasingly recognized as interests that merger and FDI scrutiny must uphold.

COVID and geopolitical tensions further complicate foreign direct investments

Governments will not be passive observers to unwelcome transactions and they will seek to validate their political agendas.

Screened FDI Cases Germany



China prohibits foreign companies from investing in their infrastructure, prohibits companies from being active in China - without joint ventures, in case of doubt. And we then allow all this in our country?



“The world should no longer be to the play of the markets. The primacy of businesses must end.”

Similarities and Differences: CFIUS & German FDI

07

Similarities and Differences: Covered Transactions

CFIUS

- Any transaction that could result in "control" of a U.S. Business by a foreign person
- "Control" is defined broadly as power, direct or indirect, whether or not exercised, to determine, direct, or decide important matters affecting a business, and can include minority investments
 - e.g., board seat, entry into significant contracts; appointment of dismissal of employees
- Certain foreign non-controlling (equity) investments in U.S. businesses that deal with critical technology, critical infrastructure, or the sensitive personal data of U.S. citizens ("TID" businesses)

German FDI

- Asset Deal and Share Deal (certain threshold of voting rights, i.e. 10 / 20 / 25%)
- Direct and indirect acquisitions
- Incl. Group internal organization (except if acquisition is exclusive between companies whose responsible shares are held by same controlling company and with headquarter in the same third country)
- Plus additional seats in supervisory board or management; granting veto rights in case of strategic business or personnel decisions; granting of certain information rights in the meaning of Sec. 15 IV lit. 3 AWG

Similarities and Differences: Sectors of Interest

CFIUS

- Sector specific
 - Aerospace and defense sector
 - TID (critical technology, critical infrastructure, or sensitive personal data)
 - Critical and emerging technologies
- Cross sectoral
 - Any sector with a national security nexus can be implicated
 - “National security” is not defined in the regulations and is interpreted broadly by CFIUS

German FDI

- Sector specific
 - Defence technology goods covered by patent / utility model patent
 - IT Security
 - Facilities vital to defence
- Cross sectoral
 - Basically any and all sectors
 - But 27 sectors particularly relevant and conclusively listed
 - Seven most sensitive sectors triggered by acquisition of 10%
 - Remaining 20 by acquisition of 20%

Similarities and Differences: Protected Interests

CFIUS

- Risk to national security
 - Deliberately broad (with significant discretion)
 - Long established (since 1975) with detailed regulations and legislative guidance
 - Process tracks policy trends
 - Countries of concern, such as Russia and China, receive additional scrutiny under current geopolitical landscape

German FDI

- Impairment of public order and safety
 - Deliberately broad
 - Less clear than in the US
 - Process prone to politization
 - "Additional influence" to be taken into account

Similarities and Differences: Political Interest Triggers

CFIUS

- U.S. technological leadership in areas affecting national security, such as sensitive critical technologies (e.g., AI, supercomputing)
- The resilience of critical U.S. supply chains
- Aggregate industry investment trends that may have consequences for a given transaction's impact on U.S. national security
- Cybersecurity risks
- Risks to U.S. person's sensitive data
- Involvement of countries of concern (China, Russia)

German FDI

- At Buyer Level
- At Target Level
- Control questions:
 - Could the transaction affect security of supply or domestic know-how?
 - Could the transaction be detrimental to strategic autonomy?
 - Does this deal affect current political priorities (chips, energy security...)?

Similarities and Differences: Mandatory Filings

CFIUS

- **Critical Technologies:** Foreign investments involving a TID U.S. business that produces, designs, tests, manufactures, fabricates, or develops one or more critical technologies for which a U.S. regulatory authorization would be required for the export, reexport, transfer (in-country), or retransfer of such critical technology to that foreign person
- **Foreign-Government Ownership:** Certain transactions in which a foreign-government owned entity acquires a substantial interest in a TID U.S. business

German FDI

- **Sector-specific:** Acquisition of at least 10% of voting rights by any foreign investor
- **Cross sectoral:** Conclusively listed 27 sectors by Non-EU / Non-EMEA investor in case relevant threshold is met

Similarities and Differences: Process Timelines

CFIUS

- Draft filing typically takes 3-4 weeks to prepare the draft filing; process typically starts after signing, and CFIUS usually takes 1-2 weeks to review
- Declaration (abbreviated filing): 30 day assessment period
- Notice (long-form filing): Review timeline includes 45-day review, 45-day investigation (as needed), and 15-day presidential review (as needed)
- Parties may withdraw and abandon transaction or refile after restructuring

German FDI

- Draft filing right after signing or ideally prior to signing (once key terms agreed)
- 2 months review period for BMWK (after complete set of docs obtained) , additional four months review period upon notification by BMWK
- Press releases and media coverage have to be in line with narrative presented to Ministry

Similarities and Differences: (Potential) Legal Penalties

CFIUS

- Three types of violations: failure to file; non-compliance with CFIUS mitigation; material misstatement, omission, or false certification
- Potential civil penalties:
 - For failure to comply with mandatory declaration requirements or violations of a material provision of a mitigation requirement → up to \$250,000 or the value of the transaction, whichever is greater; and
 - For material misstatements, omissions, or false certifications → up to \$250,000 per violation
- Potential ordered divestiture of a completed transaction
- Very limited judicial recourse (see e.g., *Ralls*)

German FDI

- Mandatory filing: Prohibition to close prior to (deemed) approval, in case of Closing / Information Exchange (Due Diligence) / voting rights prior to (deemed) approval – fines and prison sentence
- Non-filing (in case of non-mandatory filing): BMWK may take up the transaction for review within five years after signing
- Appeal possible?
(+) but executive prerogative

Similarities and Differences: Strategic Communications

CFIUS

- Confidential filing process (subject to other disclosure requirements, such as SEC)
- Engage with Committee early in the transaction stage, and continue to coordinate throughout the review process
- Anticipate potential national security considerations and sensitivities, and structure deal to mitigate these risks
- Build solid working relationship and transparency with the Committee
- Consider strategic comms campaign with policymakers and/or Congress—although note that this can complicate the process

German FDI

- Involve competent authority early on to avoid politicization and keep review at working level
- Be prepared: understand how your transaction relates to current political priorities, also to determine the risk of the deal being lifted to the political level or covered by media
- Be aware of certain “triggers” for politicization
- Define possible mitigating measures early on, if possible, structure deal around these measures from the start
- Identify allies and opponents and determine if/when to approach allies in the process
- Identify ways to connect the deal to larger strategic interests
- Maintain one voice policy, ideally across buyer and target. Identify spokespeople that can speak to media and regulators
- Consider visits from the buyer side to Germany to establish trust

Key Takeaways and Looking Ahead

08

Outlook for CFIUS

- CFIUS will continue to be a **prominent** national security tool
- Increased importance of **national security due diligence** to determine appropriate calibration of risk
 - CFIUS (and potential outbound investment) due diligence should be prioritized given Administration's focus on this area
 - Certain sectors are higher risk, specifically semiconductors and microelectronics, supercomputing and quantum computing, AI, biotech, EV and battery technology, nuclear fusion, hypersonics and space technologies
- Potential for **increased transaction timelines**
- Heightened investor scrutiny by the USG, particularly in transactions with a China nexus
 - Potential for increased risk in **non-notified transactions** coming to attention of CFIUS and being subject to mitigation or unwinding
 - Potential increased focus on CFIUS **enforcement** also impacts risk calculus for voluntary filings
- **Outbound investment review** ("Reverse-CFIUS") is gaining traction and is an increasing focus for the Executive and Congress

Outlook for German FDI

- Like CFIUS, FDI will continue to be a **prominent** national security tool, with further tightening likely
- Increased importance of FDI due diligence and determination if transaction/target require a mandatory filing
 - Conclusively listed 27 sectors re of particular relevance
 - Transaction structure (with potential additional rights of minority investor) to be reviewed early on, exact structure of Purchaser TBC early in process
- Potential for **increased transaction timelines and transaction CPs**
- Heightened investor scrutiny by the BMWK, particularly in transactions with a China nexus → Regular screening of press publications by the authorities, i.e. potential take up of **non-notified transactions** by BMWK, alternative filing for certificate of non-objection
- **FDI Screening Bill** expected for the summer
- Discussion on **outbound investment restrictions** in early stages
 - Outbound investment restrictions also part of EU Commission's work programme for 2023



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