



**Foley Hoag M&A Forum**

# Navigating Regulatory Compliance – It's All in the Details

June 2023



# Today's Speakers

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# Agenda

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|---|-------------------------|
| 1 | CFIUS                   |
| 2 | Antitrust/HSR           |
| 3 | Privacy & Data Security |
| 4 | Q&A                     |

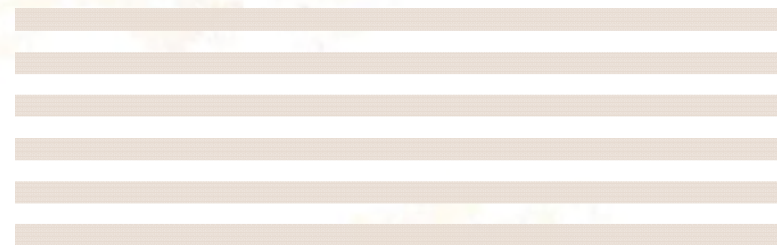
## Housekeeping

- Add your questions to the Q+A Section. Questions will be addressed at the end.
- Materials and a recording will be circulated following the event.
- A CLE Code will be provided later in the presentation.



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CFIUS



# CFIUS: Overview

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- Committee on Foreign Investment in the United States (CFIUS)
- CFIUS is an interagency committee authorized to review certain transactions involving foreign investment in the United States and certain real estate transactions by foreign persons, in order to determine the effect of such transactions on the national security of the United States.
- Chaired by the Secretary of the Treasury
- In existence since 1975
- Authority significantly expanded in 2018
  - Pursuant to the Foreign Investment Risk Review Modernization Act
  - Implementing regulations issued by CFIUS in 2020



Composition of CFIUS

# CFIUS: Covered Transactions

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1. Control transactions: a transaction that could result in a U.S. business is being “controlled” by a foreign person
  - Includes acquisitions, but could also cover minority investments where foreign person has significant influence over “important matters”
  - Foreign person = (a) foreign national, government, or entity OR (b) any entity over which control can be exercised by a foreign national, government, or entity
    - Thus, a U.S. branch of a non-U.S. parent company is considered a foreign person
2. Covered investment: non-controlling investments in “TID” U.S. businesses (i.e. those involved in critical Technology, critical Infrastructure, and/or sensitive personal Data)
3. Real estate in close proximity to sensitive facilities
  - Military bases
  - Ports/airports

# CFIUS: Exemptions

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1. Passive investments where foreign person holds 10% or less of outstanding voting interests in a U.S. business
2. Incremental acquisitions
  - If foreign person acquires additional interest in a U.S. business when CFIUS has cleared previous investment
3. Excepted Investors
  - From Australia, Canada, New Zealand, and the UK
  - At least 75% of board members and observers AND all 10% or greater shareholders must be from an excepted state or the U.S.
4. Securities underwriter transactions
5. Acquisitions pursuant to a condition in an insurance contract
  - i.e. fidelity, surety, or casualty obligations
6. Lending transactions
  - Unless foreign person acquires financial/governance rights akin to an equity investment OR there is an imminent default risk that could give control to a foreign person

# CFIUS: Mandatory vs Voluntary Filings

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- Mandatory filing if:
  - Substantial interest by foreign government
    1. A TID U.S. business is involved; AND
    2. A foreign person obtains a 25% or more voting interest; AND
    3. A foreign government (except from an excepted state) hold 49% or more voting interest in foreign person
  - Critical Technology
    1. The U.S. business is involved in critical technology; AND
    2. A U.S. export authorization (with certain exceptions) would be required to export the technology to the foreign investor or any person holding 25% or more voting interest in foreign investor
- Voluntary filing in all other circumstances
  - May want to file anyway if:
    - ♦ Transaction raises national security concerns
    - ♦ Chinese or Russian investors are involved
    - ♦ Parties would prefer to prevent CFIUS risk from arising at later date
    - ♦ Target sells to US Government
- Often the foreign person will take the lead on deciding whether to make a voluntary filing

# CFIUS: Declaration or Notice?

- CFIUS expects any filing to be submitted jointly by the parties, which should each be separately represented (CFIUS will often ask if the parties have their own counsel)
- A declaration is a short-form version of the CFIUS filing

| Pros                                                           | Cons                                                                                                      |
|----------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------|
| Less burdensome to prepare than a notice                       | Sometimes inconclusive: CFIUS often responds with a “shrug” or worse, orders the parties to file a notice |
| Shorter time line (30 days) than a notice for CFIUS to respond |                                                                                                           |
| Free (no filing fee)                                           |                                                                                                           |

- Potentially useful if:
  1. The transaction is perceived as low-risk from national security standpoint;
  2. The foreign person has previously filed with CFIUS and is known to the Committee

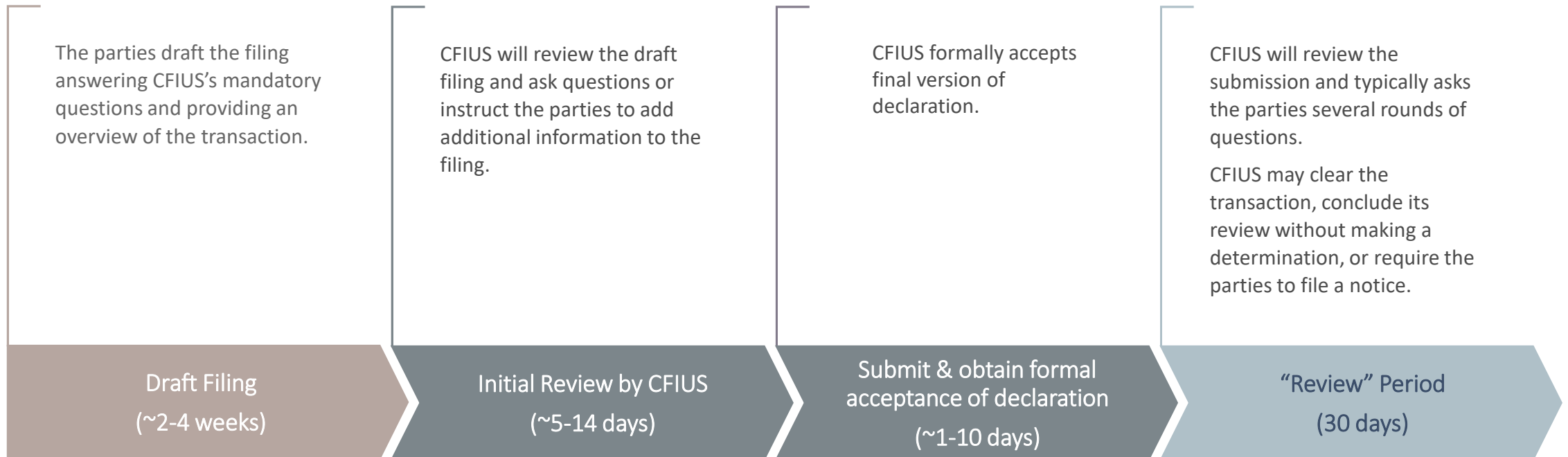
# CFIUS: Declaration or Notice?

- A notice is a full CFIUS filing

| Pros                                                                                                                           | Cons                                                                                                                                                                                                                                                                                             |
|--------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Decisive: you will get an up or down determination from CFIUS at the end of the process                                        | Burdensome: especially for foreign person as sensitive personal data must be disclosed including national identity number, passport information, etc. including for all senior officers, directors, and individual shareholders who own 5% or more of the direct purchaser and any parent entity |
| CFIUS will get to know foreign person (especially useful for entities that plan to make multiple acquisitions of US companies) | Can be expensive                                                                                                                                                                                                                                                                                 |
|                                                                                                                                | Takes longer than the declaration review process                                                                                                                                                                                                                                                 |

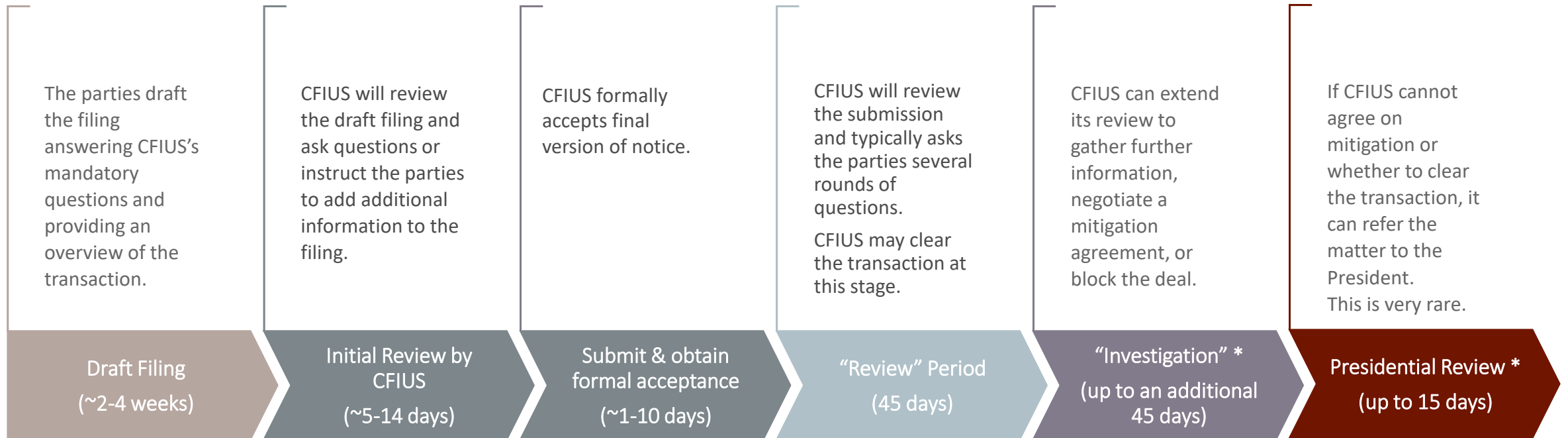
- Useful if:
  1. The parties want to eliminate CFIUS risk
  2. The transaction is perceived as higher-risk from national security standpoint;
  3. The foreign person is not known to the Committee

# CFIUS: Declaration Timeline



\* = if necessary

# CFIUS: Notice Timeline



\* = if necessary

# Incorporating CFIUS Considerations Into Transaction

## Cross-Functional Support Needed

### International Trade

- Determine/collect export classification information
- Determine if export license is required for foreign investor(s)

### IT

- Cybersecurity plan
- Policies and procedures

### Contracts / Gov Contracts

- Information on any government contracts
- Information on any DPAS priority orders

### Data Privacy

- Types of sensitive personal data collected/stored by company
- Policies and procedures regarding retention of sensitive personal data

### Legal / Deal Team

- Description of transaction
- Rights being received by foreign person

### IP

- Copies of patents
- Details on licensing arrangements

# CFIUS: Fees and Penalties

- Failure to submit mandatory filing could result in civil penalty of up to \$250k or the value of the transaction (whichever is greater)
- Filing fees for notices:

| Value of the transaction                                           | Filing fee |
|--------------------------------------------------------------------|------------|
| Less than \$500,000                                                | No fee     |
| Equal to or greater than \$500,000 but less than \$5 million       | \$750      |
| Equal to or greater than \$5 million but less than \$50 million    | \$7,500    |
| Equal to or greater than \$50 million but less than \$250 million  | \$75,000   |
| Equal to or greater than \$250 million but less than \$750 million | \$150,000  |
| Equal to or greater than \$750 million                             | \$300,000  |

- CFIUS regulations do not specify who pays so parties will have to negotiate this and include in deal docs

# CFIUS: Potential Outcomes of Filing

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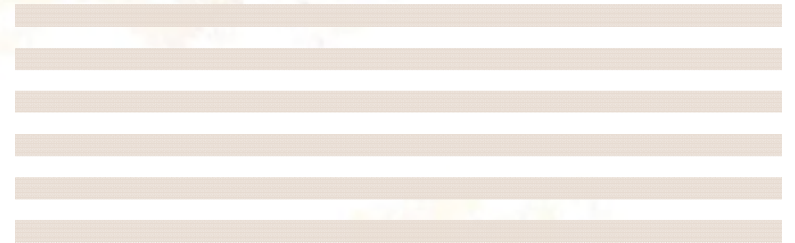
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- CFIUS can clear the transaction (“no unresolved national security concerns”)
- CFIUS/President can block the transaction
- CFIUS can negotiate a “mitigation” agreement with the parties that could include:
  - Divestiture(s) of sensitive assets
  - Requirement that only U.S. persons be involved with working on/managing certain parts of the business
  - Limiting foreign owner’s access to information/intellectual property
  - Requiring a government monitor
- For declarations, CFIUS could indicate that it does not have enough information to assess national security implications (usually a good sign) or require the parties to submit a full notice



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Antitrust/HSR



# What is the Hart-Scott-Rodino (HSR) Act?

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- Provides the Federal government advance notification of transactions over a certain size and of a particular character.
- Triggers a waiting period prior to consummating the transactions.
  - Initial waiting period expires automatically 30 days from the completion of the HSR filing (or 15 days in the case of a cash tender offers) unless the agencies either:
    - ◆ Request additional information about the transaction (a “Second Request”) OR
    - ◆ Grant early termination of the waiting period.
- The Federal Trade Commission (FTC) and the U.S. Department of Justice (DOJ) jointly enforce the federal antitrust laws
  - State Attorneys General do not automatically get access to the HSR filings.

# Early Termination Is Unavailable

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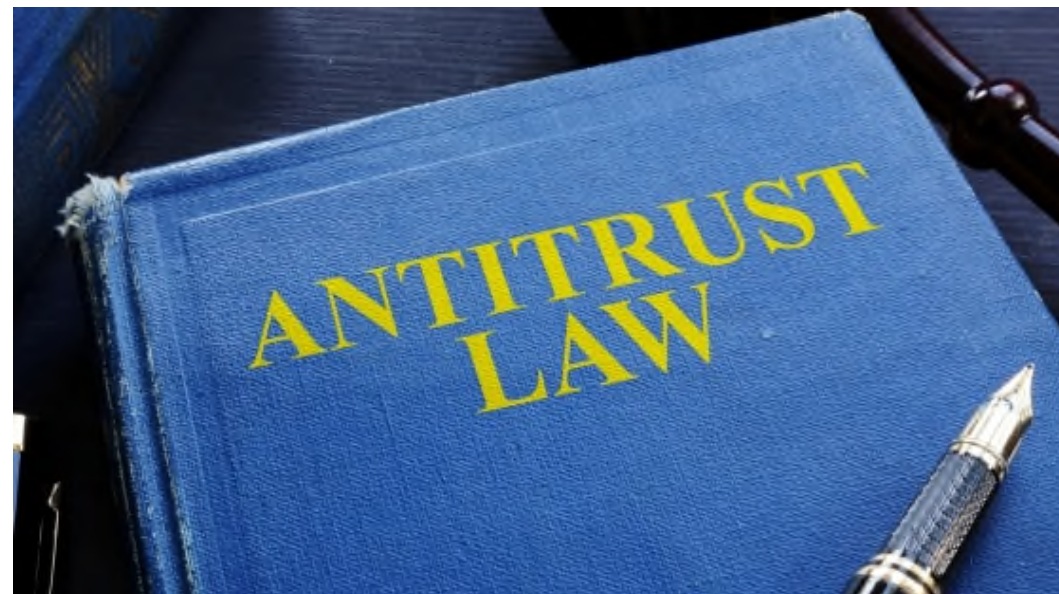


# HSR: When to File

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- Commerce Test
- Size of Transaction Test (adjusted annually)
  - Transaction value is over \$111.4 Million
- Size of Person Test (adjusted annually)
  - Only applies if transaction value is below \$445.5 million
  - One party has sales or assets of over \$222.7 million and the other party has sales or assets of at least \$22.3 million
- Exceptions



# Transaction Value

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- Aggregate all Previous Acquisitions
  - Beware Appreciation
- Conversions/Exchanges of Securities
- Exclude Non-Voting Securities
  - Options/Warrants
- Exclude Transaction Costs

# Exemption Considerations

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- Pro-Rata/Dilution
- Retired Debt
- Investment Only
- Foreign Sales/Assets
- Government Investors
- Real Estate

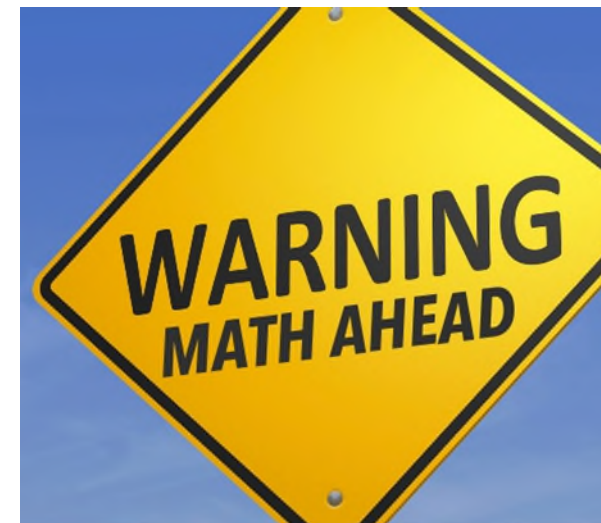


# Consequences of Failure to File

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- Embarrassment
- \$50,120 per day for both filing parties
  - $(50,120 \times 180 = \$9,021,600)$
- Agencies can still investigate competition concerns
  - Even if the transaction is non-reportable
  - Even if the transaction was consummated
- Most first-time offenders get off with a warning



# Two Most Common Failure to File Scenarios

- Acquisitions by company executives, officers, and directors
  - Individuals not aware of the HSR Act and potential filing obligations
  - Failure to properly aggregate shares already held with the new shares
- Acquisitions that are no-longer eligible for the Passive Investor exemption
  - Any acquisition that would result in holding more than 10% is ineligible for the exemption, regardless of the investor's continued passive intent
  - If there is no longer a purely passive intent, there is no exemption for subsequent acquisitions and previous acquisitions must be aggregated



# Atypical HSR Filings

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- Warrants, Options and Convertible Notes
  - The exchange of one type of interest for another may trigger an HSR filing and waiting period even if exchanging one interest for another in the same company
- Backside Transactions
  - If the consideration in a transaction includes voting securities from the buyer, there may be an HSR filing obligation and waiting period
- Exclusive Licenses
  - Licenses agreements that transfer "all commercially significant rights" may trigger an HSR filing obligation
- Open Market Acquisitions, Tender Offers and Secondary Offerings
- Transfers between Funds and Changes in Corporate Structure



# M&A Specific HSR Considerations

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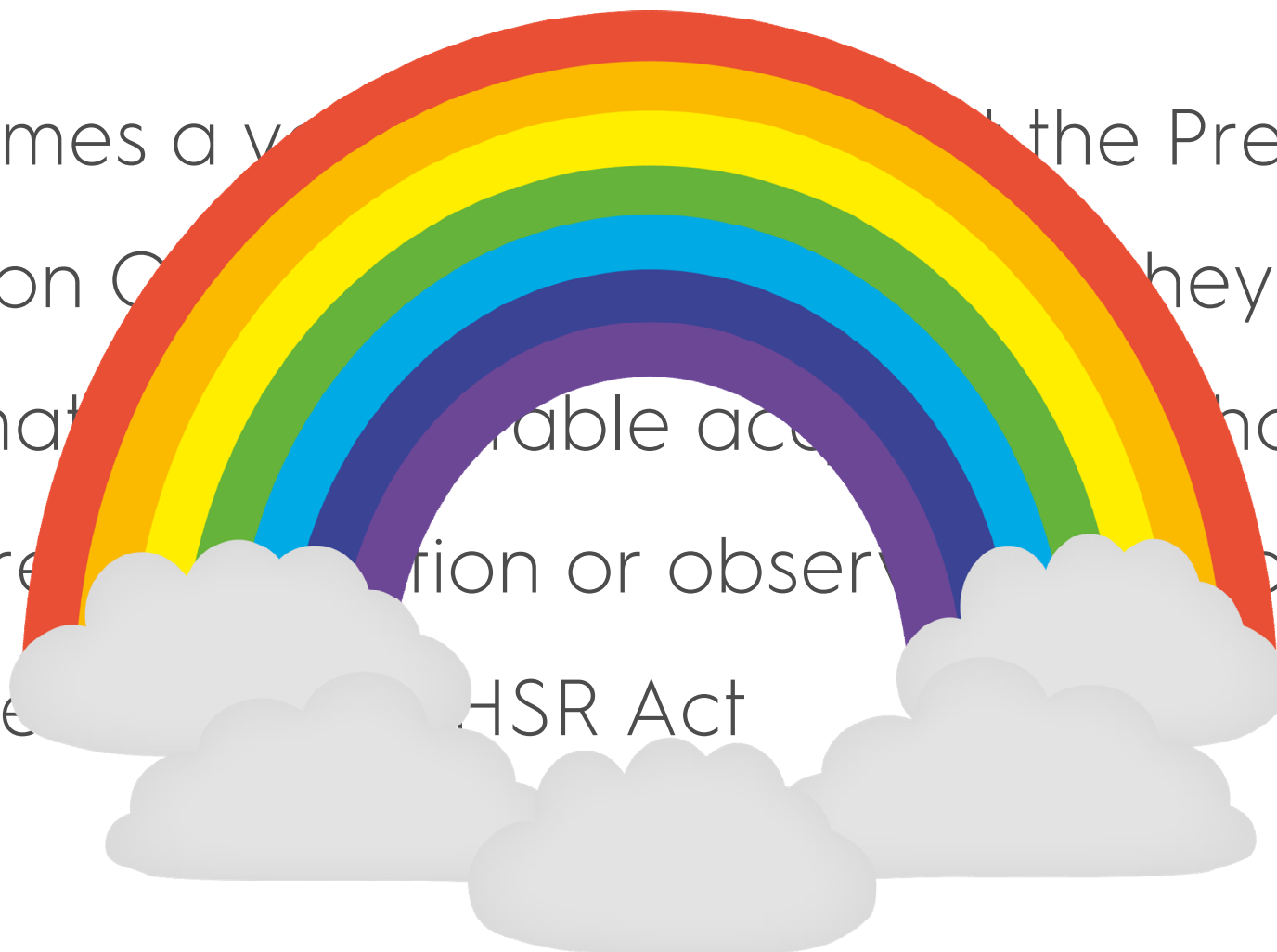
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- Aggregation
- Roll-over Equity
- Clean Team
- Gun Jumping
- Foreign Filings
- State AGs



# Corrective Filings

- Several times a year, the Premerger Notification Office (PNO) identifies companies that have consummated a transaction without filing the required notification or observation appropriate waiting period under the HSR Act.





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# Privacy & Data Security



# Privacy and Data Security Overview

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- Personal Information is an important corporate asset
  - As part of an M&A transaction, entities must evaluate how a potential target protects and maintains personal information
- The privacy framework is a patchwork
  - M&A deal teams must evaluate how legal regimes such as U.S. federal and state law, the EU's General Data Protection Regulation ("GDPR"), and antitrust law impact the use of personal information
- Due Diligence into privacy and data security issues during an M&A transaction are necessary for the continued use of personal information and management of data breach liabilities

# Legal Concerns

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- Deal lawyers need to evaluate statutory and regulatory requirements as to personal information
  - Sector-specific requirements in the U.S. determine what may be disclosed and how
- No federal U.S. law addressing data privacy
  - The Federal Trade Commission (“FTC”) is the primary federal regulator of privacy and data security
    - ♦ Sec. 5 of the FTC Act prohibits “unfair or deceptive acts or practices in or affecting commerce” and has been interpreted to allow the FTC to enforce privacy and security concerns
    - ♦ FTC regulations = common law for data privacy
    - ♦ Acquirers must honor privacy promises made by targets or obtain consent if there are changes to how personal information will be collected, used, or disclosed

# Legal Concerns – U.S. Federal Law

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- Sector-specific laws also impact M&A transactions
  - E.g., Gramm-Leach-Bliley Act (“GLB”)
    - ◆ Allows disclosure by a financial institution of client’s non-public personal information as part of a sale, merger, or transfer of all or a portion of a business
    - ◆ But limited to the data of clients in the business involved in the transaction
  - E.g., Health Insurance Portability and Accountability Act (“HIPAA”)
    - ◆ Covered entities can disclose protected health information without obtaining the consent of the individual subject to the disclosure for “health care operations”
      - ▶ This includes the sale, transfer, merger, or consolidation of a covered entity and related due diligence
      - ▶ As a result, covered entities can transfer health information between themselves in a M&A transaction

# Legal Concerns – U.S. State Law

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- In lieu of a federal privacy law, several states have passed comprehensive privacy bills:
  - CA, CO, CT, IN, IA, MT, TN, TX, UT, VA
- California Consumer Privacy Act (“CCPA”) of 2018
  - Shares certain principles with GDPR
  - “Personal Information” includes “information that identifies, relates to, describes, is capable of being associated with, or could reasonably be linked, directly or indirectly, with a particular consumer or household”
    - ◆ As a result, this includes a person’s name, postal and email addresses, Social Security number, Internet activity, geolocation data, as well as “inferences drawn from any of the information identified”
  - CCPA also provides consumers with rights as to personal information, such as the right to deletion and not to sell

# Legal Concerns – U.S. State Law, con't

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- Consequently, the target's protection and disclosure of personal information must comply with all applicable state privacy and data security laws
- The deal team should ensure they are familiar with these laws and requirements and how they apply to the target's business and potentially the business post-closing
- The target's privacy policies should be reviewed as part of due diligence to ensure they reflect these requirements
- Most state laws require an entity to implement and maintain "reasonable" security procedures appropriate for the nature and size of the business

# Legal Concerns – GDPR

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- The definition of “personal information” under GDPR is expansive
- Identifying the geographic scope of a deal is important, including:
  - Where the target has facilities
  - Does the target offer goods/services to individuals in the European Union
  - Does the target monitor the behavior of EU residents
  - Is the target required to comply with GDPR and has it done so
- If a deal is impacted by GDPR, then the following should be analyzed:
  - the legal bases on which the target processes personal information
  - If the target has performed data protection impact assessments re. high-risk activities
  - Compliance with cross-border data transfer
  - Review of vendor contracts for GDPR compliance

# Role of Due Diligence

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- The acquirer should understand the personal information held by the target and safeguards to protect
- The acquirer should understand how it can use the target's data after closing
- Relevant questions to ask as part of due diligence:
  - Jurisdictions in which the target operates
  - Is the target in compliance with privacy and data security laws in those jurisdictions
  - What data processing activities are performed by the target? Are any high-risk?
  - Whether the target processes regulated or sensitive data (e.g., data subject to GLB or HIPAA)
  - Where does the target store personal information and what safeguards are used to protect personal information

# Role of Due Diligence, con't

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- Relevant questions, con't:
  - If the target engages in cross-border transfers
  - If the target has been the subject of any investigation regarding privacy or data security from regulators
  - Whether the target has been accused of violating privacy or data security laws
  - Has the target suffered a data security breach
- Due diligence should review materials that highlight the target's infosec practices
  - E.g., incident response plan, monitoring notices, vendor contract, data security assessments, privacy policies
- Understand the history of data breaches and security incidents
- Goal: Discover the target's privacy and data security practices and identity related risks



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# CLE CODE

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*CLE approved in NY and CA*

Please direct all CLE requests to Kelly Yergeau at [kyergeau@foleyhoag.com](mailto:kyergeau@foleyhoag.com).



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# Questions?

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