

Caveat Emptor: What You Need to Know About International Mergers & Acquisitions

**Co-sponsored by the International, Antitrust, Business
Law, Corporate Counsel, and Intellectual Property
Sections**

Speakers:

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Geoffrey M. Goodale (Moderator)

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Degremont is a full-service treatment expert, providing design and equipment supply for all stages of water, wastewater, and biosolids management. Responsible for assisting the legal and management team of a national water treatment company. Help company comply with all federal, state, and local laws relating to water treatment facility installations as a supplier and/or subcontractor. Provide legal advice to company and subsidiaries in the U.S. and Canada. Conduct legal research relating to contractual terms and conditions, corporate transactions, mergers and acquisitions, corporate financing, and SOX compliance. Conduct contract negotiations and advise on corporate policy direction. Provide legal advice to business units about intellectual property protection.

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Jocelyn West Brittin practices in the areas of mergers and acquisitions, corporate finance, technology transfers and licensing, e-commerce and intellectual property law. Ms. Brittin provides counseling on protection and licensing of rights to software developers, technology companies and technology purchasers in a wide range of market segments. She regularly drafts, reviews and negotiates contracts in the technology area, including product line sales, software licensing, enterprise-wide licensing and outsourcing, co-branding, joint development projects, distribution agreements, and Internet advertising. Her corporate practice includes mergers, stock and asset acquisitions, private equity financings and general corporate work. She regularly counsels closely-held companies on a wide range of commercial issues.

Prior to entering private practice, Ms. Brittin clerked with the U.S. District Court for the Southern District of Florida and with the U.S. Court of Appeals for the Fourth Circuit.

Honors & Awards

The Best Lawyers in America guide, Corporate Law; Information Technology Law; Securities/Capital Markets Law, 2006-2015

Best of U.S. Corporate Attorneys

Who's Who Registry of National Business Leaders for Professionals and Executives

Top Ten Technology Lawyer, Virginia Business Magazine

Martindale-Hubbell AV Preeminent Peer Review Rated

Memberships

Women In Technology

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College of William & Mary School of Law, J.D.

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Biography- J. Brent Justus

Brent focuses his practice on antitrust and trade regulation, class action litigation, and complex commercial litigation. He has litigated matters in federal courts throughout the United States and has handled cases under virtually every aspect of the antitrust laws including monopolization, price fixing, vertical conspiracies, boycotts, and price discrimination, as well as a number of state antitrust and unfair competition statutes. Brent also has successfully represented both corporate clients and individuals in criminal antitrust cartel cases in the United States and Canada. His practice has included representation of clients before the U.S. Department of Justice, Federal Trade Commission, the Canadian Competition Bureau, and the European Commission Directorate General for Competition.

In addition, Brent has worked extensively on merger investigations involving both domestic and European companies, has supervised the preparation of hundreds of Hart-Scott-Rodino premerger notification filings, and obtained dismissal in federal district court of an FTC lawsuit seeking to enjoin a natural gas utility merger.

Brent serves as a vice chair of the Criminal and Cartel Committee of the ABA's Antitrust Section. He is also an editor of the three-volume *State Antitrust Practice and Statutes (Fifth)* published by the ABA Antitrust Section, and is a past chair of the Antitrust Section of the Virginia State Bar.

***CAVEAT EMPTOR:
INTERNATIONAL MERGERS AND ACQUISITIONS***

Speakers:

Stephen Hanson, Staff Chairperson, Committee on Foreign Investment in the United States

Robert Barrett, Assistant Corporate Counsel, Degremont Technologies

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Presented By:

Antitrust Law Section

Business Law Section

Corporate Counsel Section

Intellectual Property Law Section

International Practice Section

**Virginia State Bar
2015 Annual Meeting
June 19, 2015**

Caveat Emptor: International Mergers and Acquisitions

1. Topics to Be Covered Relating to International Mergers and Acquisitions (“M&A”).¹
 - a. National security-related issues involved in international M&A transactions.
 - b. Merger control and antitrust issues involved in international M&A transactions.
 - c. Intellectual property-related due diligence issues involved in international M&A transactions.
 - d. Key issues from an in-house counsel’s perspective.
2. National Security-Related Issues Involved in International M&A Transactions.
 - a. According to the World Bank, 104 countries regulate foreign direct investment (“FDI”), including all of the world’s industrialized countries. See <http://iab.worldbank.org/>. Such regulations can, and do, vary widely.
 - b. U.S. regulation of FDI.
 - i. Committee on Foreign Investment in the United States (“CFIUS”) Issues.
 - (A) Sources of authority for CFIUS.
 - (1) Section 721 of the Defense Production Act of 1950, as amended by the Foreign Investment and National Security Act of 2007 (“FINSAs”). [A summary of FINSAs is attached as Appendix B.]
 - (2) Executive Order 11858 of May 7, 1995 (“EO 11858”), as amended by Executive Order 13456 of January 23, 2008 (“EO 13456”). [A summary of EO 11858, as amended by EO 13456, is attached as Appendix C.]
 - (3) 19 C.F.R. Part 800 (the “CFIUS Regulations”). [A summary of the CFIUS Regulations is attached as Appendix D.]

¹ This outline was prepared for use in connection with the program on “Caveat Emptor: International Mergers and Acquisitions” that is being presented as part of the Virginia State Bar’s 2015 Annual Meeting. Bios of the speakers for this program are included as Appendix A.

(B) Overview of CFIUS.

- (1) CFIUS is an inter-agency committee that is authorized to review transactions that could result in the control of a U.S. business by a foreign person in order to determine the effect of such transactions on the national security of the United States.
- (2) CFIUS has jurisdiction to review virtually any foreign investment transaction that may have an impact on U.S. national security. The only exception relates to “greenfield” transactions (i.e., a transaction where no existing business is being acquired), which are outside of CFIUS’ scope.
- (3) CFIUS has the ability to recommend to the President that a transaction be blocked or unwound if it concludes that the transaction may pose a national security risk to the United States, although it is rare that CFIUS makes such a recommendation and even more rare for the President to take such action.

(C) Composition of CFIUS.

- (1) The members of CFIUS include the heads of the following federal Departments and Offices are members of CFIUS.
 - (a) Department of the Treasury. (Chair)
 - (b) Department of Commerce.
 - (c) Department of Defense.
 - (d) Department of Energy.
 - (e) Department of Homeland Security.
 - (f) Department of Justice.
 - (g) Department of State.
 - (h) Office of the U.S. Trade Representative.
 - (i) Office of Science & Technology Policy.

(2) The Director of National Intelligence and the Secretary of Labor are non-voting, ex officio members of CFIUS.

(3) In addition, the following federal offices also observe, and as appropriate, participate in the activities of CFIUS.

(a) Office of Management and Budget.

(b) Council of Economic Advisors.

(c) National Security Council.

(d) National Economic Council.

(e) Homeland Security Council.

(4) Submissions to CFIUS are received, processed, and coordinated at the staff level by the Staff Chairperson of CFIUS, who is the Director of the Office of Investment Security within the Department of the Treasury.

(D) Key Issues in Deciding Whether to File a Notice with CFIUS.

(1) Determining whether the M&A transaction is a “covered” transaction.

(a) Under FINSA, a “covered” foreign investment transaction refers to any merger, acquisition, or takeover which results in foreign control of any person engaged in interstate commerce in the United States.

(b) “Control” is defined under FINSA as the power to determine, direct, or decide matters affecting an entity, including (but not limited to): (1) the sale, lease, pledge, or other transfer to the company’s assets; (2) the dissolution of a company; or (3) the closing or relocating of research and development facilities.

(c) “Control” can be acquired in a variety of ways as enumerated under FINSA, including the ownership of a majority or a dominant minority of the total outstanding voting securities, proxy voting, or contractual arrangements.

(2) Evaluating the potential national security impact of the transaction.

- (a) While the term “national security” is not explicitly defined under FINSA, the statute does identify a number of issues that fall under the category of national security, including a wide range of concerns relating to homeland security. Significantly, such concerns include those relating to “critical infrastructure,” which is defined under FINSA as “a system or asset, whether physical or virtual, so vital to the United States that the incapacity or destruction of the particular system or asset . . . would have a debilitating impact on national security.” As such, transactions that would result in foreign control over major energy assets (e.g., power plants), for example, would certainly be deemed by CFIUS to have potential national security implications.
- (b) FINSA also mandates that CFIUS consider the impact of a covered transaction on U.S. “critical technologies” that are defined under FINSA to include (but are not limited to): (1) defense items, specifically items controlled under the International Traffic in Arms Regulations; (2) export controlled and dual use items controlled under the Export Administration Regulations for national security, chemical and biological weapons proliferation, nuclear proliferation or missile proliferation reasons; (3) items controlled under the Export and Import of Nuclear Equipment and Materials Regulations; and (4) items controlled under the Export and Import of Select Agents and Toxins Regulations.
- (c) CFIUS has also issued guidance indicating that it is quite interested in whether the U.S. company being acquired develops or provides cyber systems, products, or services or whether it processes natural resources and materials or whether it produces and/or transports energy. See CFIUS FAQs (available at <http://www.treasury.gov/resource-center/faqs/CFIUS/Pages/default.aspx>.)

(E) CFIUS Review Process.

(1) Pre-Filing Activities.

- (a) While not required, parties to a proposed transaction are encouraged to consult with CFIUS in advance of formally filing a notice and/or to submit a draft notice to CFIUS staff. Any draft notice that is submitted should contain substantially all of the same information that would be required in a formal

notice. The required information that formal notice requirements are set forth under Section 800.402 of the CFIUS Regulations (31 C.F.R. § 800.402).

- (b) Any such pre-filing consultations should take place at least five business days before the submission of a formal notice, and similarly, a draft notice should be provided to CFIUS at least five business days before the filing of a formal notice. Ideally, such pre-filing actions should be undertaken earlier than that in order to provide CFIUS staff with additional time to provide comments.

(2) 30-Day Review Period.

- (a) Once a voluntary notice has been filed with CFIUS in both written and electronic format and CFIUS staff have determined that the submission contains all of the information required pursuant to Section 800.402 of the CFIUS Regulations (and is, therefore, complete), a copy of the notice is distributed to all CFIUSs agencies. The review period then commences the next business day.

Practice Tip: All files electronically must be no larger than 5 MB in size due to CFIUS firewall restrictions. As such, larger files must be broken down into multiple files of 5 MB or less when being submitted electronically to CFIUS. In addition, when a file is larger than 5 MB and is publicly available on the Internet, CFIUS prefers that a hyperlink to that document be provided rather than a PDF copy of the document.

- (b) After a voluntary notice has been accepted and distributed to the CFIUS agencies, the CFIUS Staff Chairperson will notify the parties in writing of the date that the review period began and the date on which the 30-day review period will end. The review period will end no later than 30 calendar days after the review period has commenced, or if the thirtieth calendar day is not a business day, the next business day after the 30th calendar day.
- (c) In many cases, CFIUS will conclude either that the proposed transaction is not a covered foreign investment transaction, or that, if it is a covered foreign investment transaction, no national security concerns are implicated by the proposed transaction. In many instances, CFIUS will issue a “no action” determination in writing to the parties. Typically, such “no

action” determinations are made at the conclusion of the 30-day review period that is set forth under the CFIUS Regulations.

(3) 45-Day Investigation Period.

- (a) In a number of cases, CFIUS will conduct a more detailed 45-day investigation of the proposed transaction.
 - (i) Pursuant to FINSA and the implementing CFIUS Regulations, 45-day investigations are required in certain instances, such as when the proposed transaction involves transfer of control of a U.S. business to a foreign government (which includes companies controlled by foreign governments and sovereign wealth funds) or when the proposed transaction would result in the transfer of control of “critical infrastructure” to a foreign person.
 - (ii) In addition, the CFIUS Regulations provide CFIUS with the feels that a proposed transaction raises significant national security issues.
 - (iii) In the most recent annual report that CFIUS submitted to Congress in February 2015 (“CFIUS’ 2015 Annual Report”), CFIUS stated that, during 2013, it conducted 45-day investigations in approximately 50 percent of the cases in which voluntary notices were submitted to CFIUS.
- (b) During 45-day investigations in which serious national security concerns have been raised by one or more CFIUS agencies, CFIUS often will propose to parties that they take steps to mitigate such national security concerns, and in such instances, the parties very frequently agree to take such actions.
 - (i) Pursuant to FINSA and the implementing CFIUS Regulations, CFIUS possesses the authority to enter into agreements with the parties to mitigate concerns that had emerged during the review of the transaction as a condition to clearing the transaction. In addition, CFIUS has the power to monitor, enforce, and modify such mitigation agreements.
 - (ii) In CFIUS’ 2015 Annual Report, CFIUS stated that, during 2013, it used mitigation measures in approximately 11 percent of its cases. Significantly, CFIUS noted that a new mitigation measure that was used in 2013 was one pursuant

to which the U.S. Government could review and object to certain business practices if they raise national security concerns.

- (d) In the vast majority of cases in which 45-day investigations are conducted, CFIUS ultimately will issue a “no action” decision in writing to the parties at the conclusion of the investigation, although mitigation measures sometimes must be implemented as a condition of such action by CFIUS as discussed above.

(4) Presidential Review.

- (a) Pursuant to FINSIA, at the conclusion of its review of a transaction, CFIUS may recommend that the President block or unwind the transaction, and after doing so, the President has 15 days in which to decide whether to take such action.

- (b) In recent years, the Ralls transaction is the only case in which a President has blocked a transaction.

- (i) In March 2012, Ralls Corporation (“Ralls”), an Oregon corporation owned by two Chinese nationals who also held senior management positions in the Chinese-based Sany Group (“Sany”), acquired interests in four wind farm project companies in Oregon from Terna Energy USA Holding Corp. (“Terna”). Ralls planned to install wind turbines manufactured by a Chinese subsidiary of Sany at certain project sites that were acquired in the transaction to demonstrate the reliability of the wind turbines to prospective U.S. customers. Significantly, the project sites overlapped with a restricted air space and bombing zone used by the military aircraft that flew from a Naval Air Station on Whidbey Island in Oregon.

- (ii) The parties to the transaction chose not to file a voluntary notice with CFIUS prior to entering into the transaction. However, after CFIUS learned of the transaction, it requested that the parties file a voluntary notice, and Ralls subsequently submitted a voluntary notice to CFIUS, who urged Ralls not to engage in any construction activities at any of the project sites until CFIUS concluded its review of the transaction. Ralls, however, did not comply with this request and began construction at the sites.

- (iii) After conducting a 30-day review and a 45-day

investigation of the transaction, CFIUS issued orders prohibiting Ralls from taking certain actions (collectively, the “CFIUS Orders”) and recommended that the President block the transaction. On September 28, 2012, President Obama issued a Presidential Order prohibiting the acquisition and ownership, either directly or indirectly, of the wind farm project companies by the parties due to “credible evidence” indicating that the parties “though exercising control of [the companies] might take action that threatens to impair the national security of the United States.” See 77 Fed. Reg. 60,281 (Oct. 3, 2012) (the “September 2012 Presidential Order”).

(iv) Ralls appealed the CFIUS Orders and the September 2012 Presidential Order initially to the U.S. District Court for the District of Columbia (“DC District Court”) and subsequently to the U.S. Court of Appeals for the District of Columbia (“DC Circuit”). Ultimately, on July 15, 2014, the DC Circuit held that the September 2012 Presidential Order deprived Ralls of due process of law under the Fifth Amendment and that Ralls was entitled to review the unclassified information on which the President had relied in making his determination and to have an opportunity to rebut that evidence and that the DC District Court was capable of reviewing the CFIUS Order, and accordingly, the case was remanded to the DC District Court for further proceedings. See Ralls Corp. v. United States, 758 F.3d 296 (D.C. Cir. 2014). The case currently remains pending before the DC District Court.

ii. Foreign Ownership, Control or Influence (“FOCI”) Issues.

(A) Sources of authority for U.S. Government regulation of FOCI.

(1) National Industrial Security Program (“NISP”).

(a) The NISP was initially established by Executive Order 12829 of January 6, 1993 (“EO 12829”).

(b) A primary objective of the NISP is to ensure that persons and entities with access to classified or sensitive information comply with industry standards for complying with such information.

- (2) National Industrial Security Program Operating Manual (the “NISPOM”).
- (a) Issued in accordance with the NISP, the NISPOM sets forth the requirements, restrictions, and other safeguards to prevent the unauthorized disclosure of classified information and/or export- controlled information. Chapters 1 and 2 of the NISPOM contain detailed guidelines and requirements for the safeguarding of such sensitive information when a company may be subject to FOCI.
 - (b) The NISPOM is periodically updated to reflect changes in industrial security matters. Most recently, the NISPOM was updated in 2006. See <http://www.dss.mil/documents/odaa/nispom2006-5220.pdf>.
- (3) Directive-Type Memorandum 09-019 – Policy Guidance for Foreign Ownership, Control, or Influence (FOCI) (the “DTM”).
- (a) The DTM, which was originally issued by the Under Secretary of Defense for Intelligence on September 2, 2009, and was most recently updated on January 9, 2014, sets forth the official policy and procedures for the determination and mitigation of FOCI with respect to companies that hold, or are under consideration for, a facility security clearance (“FCL”). [A copy of the DTM is attached as Appendix E.]
 - (b) The FOCI procedures enumerated under the DTM are intended “to protect against foreign interests: (1) gaining unauthorized access to classified, all Communications Security (COMSEC) (classified or unclassified), or export-controlled information; (2) adversely affecting the performance of classified contracts; or (3) undermining U.S. security and export controls.”

(B) The Role of the Defense Security Service (DSS) in FOCI matters.

- (1) Pursuant to the NISP, and in accordance with the procedures set forth in the NISPOM, the U.S. Department of Defense's Defense Security Service ("DSS") is responsible for granting FCLs to U.S. companies and revoking them when circumstances warrant such action.
- (2) In addition, pursuant to the DTM, the DSS possesses the authority to make FOCI determinations for U.S. companies cleared or under consideration for a FCL.
 - (a) When a cleared U.S. company is acquired by a foreign entity and the transaction is finalized prior to having an acceptable FOCI mitigation program in place, DSS is required to invalidate any existing FCL until such time as DSS determines that the company has submitted an acceptable FOCI action plan.
 - (b) A company that has not yet been cleared and is determined to be under FOCI is ineligible for an FCL until security measures have been put in place to mitigate FOCI.

(C) Key FOCI Issues in International M&A Transactions.

- (1) Determining whether the U.S. company is under FOCI.
 - (a) Pursuant to the NISPOM and the DTM, a U.S. company is considered to be under FOCI whenever a foreign interest has the power, direct or indirect, to direct or decide matter affecting the management or operations of a company in a manner that may result in unauthorized access to classified information or may affect the performance of classified contracts.
 - (b) Significantly, the NISPOM and the DTM further specify that it is irrelevant whether the foreign interest exercises the power or not or whether it is exercisable through the ownership of the U.S. company's securities, by contractual arrangements, or other means.
- (2) Evaluating FOCI mitigation instruments and discussing them with DSS.
 - (a) When FOCI is determined to exist, there are three FOCI

mitigation instruments that parties can consider: (1) a Special Security Arrangement (“SSA”); (2) a Voting Trust; or (3) a Proxy Agreement.

- (b) While the SSA permits the foreign entity to retain the greatest degree of involvement in the U.S. company’s operations, there may be instances when DSS will require that the parties utilize a Voting Trust or a Proxy Agreement as the FOCI mitigation instrument, especially when foreign government ownership of the foreign entity exists or COMSEC issues are involved. As such, it is imperative that the U.S. company with the FCL discuss possible FOCI mitigation instruments with DSS as soon as a proposed transaction with a foreign entity is being contemplated.

Practice Tip: It can often take a considerable amount of time for DSS to approve a proposed FOCI mitigation instrument (often a month or more), and parties should take this into consideration when determining a proposed closing date and before filing a voluntary notice with CFIUS so that referenced to discussions with DSS can be included in the voluntary notice.

iii. U.S. Export Control Issues.

(A) Key U.S. Export Regulations.

(1) The International Traffic in Arms Regulations (“ITAR”).

- (a) The ITAR are codified at 22 C.F.R. Parts 120-130, and they relate to exports of defense articles (including both physical items and related technical data) and defense services specified under the U.S. Munitions List (“USML”), which is set forth at 22 C.F.R. § 121.1.
- (b) The U.S. Department of State’s Directorate of Defense Trade Controls (“DDTC”) is responsible for administering and enforcing the ITAR.

(2) The Export Administration Regulations (“EAR”).

- (a) The EAR are codified at 15 C.F.R. Parts 732 -774, and they relate to exports of commercial and dual-use items (including physical items, software, and technology). The most sensitive

items are enumerated under specific Export Control Classification Numbers (“ECCNs”) that are identified on the Commerce Control List (“CCL”) that is included as Part 774 of the EAR, while items not referenced under specific ECCNs are typically deemed to be EAR99 and can very often be exported to most destinations without an export license.

(b) The U.S. Department of Commerce’s Bureau of Industry and Security (“BIS”) is responsible for administering and enforcing the EAR.

(3) The Regulations of the Office of Foreign Assets Control (“OFAC”).

(a) The regulations administered by OFAC (“OFAC Regulations”) are codified at 31 C.F.R. Parts 501-598, and they relate to U.S. sanctions administered against certain countries, entities, and individuals.

(b) The U.S. Department of the Treasury’s Office of Foreign Assets Control (“OFAC”) is responsible for administering and enforcing the OFAC Regulations.

(B) Key Export Control Issues in International M&A Transactions.

(1) Providing Notification to DDTC.

- (a) Any entity that is registered with DDTC must provide notification to DDTC that it may potentially be acquired by a foreign person at least 60 days before any intended sale or transfer of ownership or control of the registrant to the foreign person. See 22 C.F.R. § 122.4(c).
- (b) Within 5 days following the acquisition of a registrant by a foreign person, the registrant must also provide notification to DDTC, and in that submission, the registrant must provide to DDTC information relating to how existing licenses and agreements approved by DDTC will be handled. See 22 C.F.R. §§ 122.4(a)-

Practice Tip: Given that prior approval by DDTC is required for any substantive change to a license or agreement, a registrant should discuss with DDTC how licenses and agreements may need to be modified well before the acquisition occurs and before the filing of the voluntary notice with CFIUS so that reference to discussions with DDTC can be referenced in the voluntary notice.

(2) Conducting export controls-related due diligence.

- (a) Review copies of all correspondence to or from DDTC, BIS, and OFAC and the U.S. company being acquired.
- (b) Review copies of all of company's export compliance policies and procedures.
- (c) Obtain and review representative samples of export documents, including Automated Export System ("AES") filings.
- (d) Determine whether the company manufactures, exports, or brokers defense articles or provides defense services, as defined under the ITAR, and if so, review copies of the company's DDTC registration records.
- (e) Determine whether the company exports products or technology subject to the EAR, and if so, review the company's records as to how export control classifications

were determined for such items.

- (f) Determine whether the company has employed foreign nationals, and if so, whether such foreign nationals have been provided access to export controlled-information and whether licenses have been obtained from DDTC or BIS, as applicable, to authorize such access.
- (g) Determine whether the company has exported any items to countries or entities subject to sanctions administered by OFAC, and if so, whether licenses were obtained from OFAC relating to such transactions.
- (h) Review the company's screening procedures relating to export transactions.
- (i) Review any licenses or agreements that the company has obtained from DDTC, BIS, or OFAC during the past 5 years.
- (j) Review copies of any reports of internal investigation reports of potential violations of the ITAR, EAR, or OFAC Regulations.
- (k) Review any voluntary disclosures that the company has submitted to DDTC, BIS, or OFAC.
- (l) Determine whether the company been the subject of any civil or criminal enforcement action or investigation by DDTC, BIS, or OFAC.

3. Merger Control and Antitrust Issues Involved in International M&A Transactions.

- a. More than 70 countries have enacted antitrust laws and/or merger control statutes. See <http://www.crowell.com/documents/corporate-governance-and-merger-control.pdf>. These laws can, and do, vary widely.
- b. Merger controls in the European Union ("EU") and Its Member States.
 - i. EU members are subject to Council Regulation (EC) No. 139/2004 of January 20, 2004 (the "EC Merger Regulation" or "ECMR"). [The text of the ECMR can be accessed at: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32004R0139&from=EN>.] Determining whether a proposed transaction requires that the parties submit a filing to the European Commission ("EC") pursuant to the ECMR involves a two-step analysis. Significantly, a filing must only be submitted to the EC if both steps are satisfied.

(A) **Step 1:** Determine whether the transaction exceeds both of the ECMR revenue thresholds.

(1) Threshold 1: Do the parties to the transaction (i.e., the acquirer(s) and the target) have combined revenues of more than 5 billion Euros worldwide?

AND

(2) Threshold 2: Do each of at least two of the parties to the transaction derive in excess of 250 million Euros in EU-wide revenues?

(B) **Step 2:** Will the acquirer(s) “acquire control” over the target?

(1) Under the ECMR, “control” is defined to be any of the following three things: (i) acquisition of more than 50 percent of the target company’s voting stock; **or** (ii) acquisition of more than 50 percent of the board seat representation of the target company; **or** (iii) veto power over “strategic commercial decisions” of the target company.

(2) Provided that the revenue thresholds referenced above in Step 1 are satisfied, if any party to the transaction acquires any of the forms of “control” specified above under Step 2, then a filing must be submitted to the EC. If, however, none of the forms of “control” specified above are acquired by any of the parties to the transaction, then a filing does not need to be submitted to the EC. In fact, if no such “control” is acquired by any party to the transaction, then the EC cannot exercise jurisdiction over the transaction regardless of whether the transaction may raise substantive antitrust concerns.

ii. If application of the ECMR’s two-step analysis results in a determination that a filing must be submitted to the EC, then the EC has exclusive jurisdiction over the transaction (i.e., the potentially applicable national competition agencies of the EU member states no longer have jurisdiction over a transaction once a filing is submitted to the EC). However, if no filing is required to be submitted to the EC, then the national competition agencies of the applicable EU member states retain jurisdiction over the proposed transaction.

Practice Tip: The national merger control statutes of the various EU member states can, and often do, vary significantly from one another. As such, counsel to parties involved in European-related M&A transactions should carefully evaluate the applicability of the ECMR and the potentially applicable national merger control statutes when structuring such transactions.

c. U.S. antitrust laws and premerger notification requirements.

i. Overview of key U.S. antitrust laws.

(A) The Sherman Act of 1890, as amended (the “Sherman Act”) prohibits unreasonable restraints of trade (e.g., arrangements among competing individuals or businesses to fix prices, divide markets, or rig bids) and monopolization, attempted monopolization, and conspiracies or combinations to monopolize.” See 15 U.S.C. §§ 1-7.

(1) Both civil and criminal enforcement actions can be pursued under the Sherman Act, and the U.S. Department of Justice (“DOJ”) has made it known that it will pursue criminal prosecutions in instances where there have been intentional and clear violations (e.g., when competitors fix prices or rig bids).

(2) Under the Sherman Act, criminal penalties can of up to \$100 million for a corporation and \$1 million for an individual can be imposed, along with up to 10 years in prison.

(B) The Federal Trade Commission Act of 1914, as amended (the “FTC Act”) bans unfair methods of competition and unfair or deceptive acts or practices. See 15 U.S.C. §§ 41-58.

(1) In addition to the actionable items explicitly specified under the FTC Act, the U.S. Supreme Court has held that violations of the Sherman Act also violate the FTC Act. As such, the Federal Trade Commission (“FTC”), which has exclusive jurisdiction relating to the FTC Act, can bring cases under the FTC Act for the same kinds of activities that violate the Sherman Act.

(2) Under the FTC Act, the FTC can bring actions in federal district for civil penalties of \$11,000 per violation, or in the case of continuing violations, of \$11,000 per day, against a party bound by the terms of a final FTC order.

(C) The Clayton Act of 1914, as amended (the “Clayton Act”), addresses

certain practices that the Sherman Act does not clearly prohibit, such as mergers and interlocking directorates. See 15 U.S.C. §§ 12-27.

(1) Section 7 of the Clayton Act prohibits mergers and acquisitions where the effect “may be to substantially lessen competition, or to tend to create a monopoly.”

(3) As amended by the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (“HSR Act”), the Clayton Act requires companies planning large mergers or acquisitions to file premerger notification submissions. In addition, as discussed in more detail below, the HSR Act establishes waiting periods that must elapse before certain acquisitions or tender offers may be consummated and authorizes the enforcement agencies to stay those periods until the companies provide certain additional information about the proposed transaction. See 15 U.S.C. § 18a.

(D) In addition to the federal statutes referenced above, most states have enacted antitrust laws that are enforced by the attorney generals of the states or private plaintiffs. Many of these state laws are patterned after the above-referenced federal antitrust statutes.

ii. Overview of Steps Involved in the HSR Merger Review Process.

(A) **Step 1:** Filing notice of a proposed transaction.

(1) If the proposed transaction meets certain a minimum value and the parties meet a certain minimum size requirement, then filings must generally be submitted to the FTC and the DOJ. These filing thresholds are updated on an annual basis by the FTC. The 2015 filing thresholds were published by the FTC on January 21, 2015. See 80 Fed. Reg. 2,934 (Jan. 21, 2015).

(2) Certain stock or asset purchases are exempt from filing requirements, as are purchases of some types of real property.

(3) When filings are required, both buyer and seller typically must file a Premerger Notification and Report Form and provide data about their industry and their own businesses (the “Premerger Filings”).

(4) There is a filing fee for Premerger Filings. Currently, the filing fee can range from \$45,000 to \$280,000 depending on the size of the deal. See <https://www.ftc.gov/enforcement/premerger-notification-program/filing-fee-information>.

- (5) Once the Premerger Filings have been submitted and deemed complete, the parties must wait 30 days, or 15 days in the case of a cash tender offer or a bankruptcy) or until the agencies grant early termination of the waiting period before they consummate the deal.

(B) Step 2: Clearance to one reviewing agency.

- (1) While parties submit their Premerger Filings to both the FTC and the DOJ, only one agency will review the proposed merger. FTC staff and DOJ staff consult with each other, and the matter is “cleared” to one agency for review.
- (2) Once clearance has been established, the investigating agency can obtain non-public information from various sources, including the parties to the proposed transaction or other industry participants.

(C) Step 3: Waiting period expires or the agency issues a Second Request.

- (1) After a preliminary review of the Premerger Filings, the investigating agency can either: (i) terminate the waiting period prior to the end of the waiting period (i.e., grant “Early Termination” or “ET”); or (ii) allow the initial waiting period to expire; or (iii) issue a Request for Additional Information (“Second Request”) to each party asking for more information.
- (2) If the waiting period expires or is terminated, the parties may proceed with closing the transaction.
- (3) If the investigating agency issues a Second Request to the parties, this extends the waiting period and precludes the parties from completing the transaction until they have “substantially complied” with the Second Request and observed a second waiting period.
- (4) Second Requests often ask for such things as business documents and data that will provide the agency with additional insights about the company’s products or services, market conditions where the company does business, and the likely competitive effects of the merger.

(D) Step 4: Parties substantially comply with the Second Request.

- (1) Once both parties have “substantially complied” with the Second

Requests, the investigating agency typically has an additional 30 days to review the materials and take action, if necessary. In cases involving a cash tender offer or a bankruptcy, once the parties have “substantially complied” with the second requests, the agency has 10 days to complete its review of the proposed transaction.

- (2) The length of time for this phase of the review may be extended by an agreement between the parties and the agency in an effort to resolve any remaining issues without litigation.

(E) **Step 5:** The waiting period expires of the agency challenges the deal.

- (1) At this stage of the review process, there are three possible outcomes: (i) the agency closes the investigation and the parties can proceed with closing the transaction; (ii) the agency enters into a negotiated consent agreement with the parties that may include provisions that are intended to restore competition in certain ways; or (iii) the agency seeks to stop the entire transaction by filing for a preliminary injunction in federal court pending an administrative trial on the merits.

- (2) In instances where the parties believe that the agency is inclined to seek a preliminary injunction in federal court, it is not uncommon for the parties to choose to abandon the proposed transaction.

- (3) In many cases, though, merger challenges are resolved with a consent agreement between the agency and the parties.

4. IP-Related Due Diligence Issues Involved in International M&A Transactions.

- a. When evaluating the intellectual property (“IP”) assets of a target company, due diligence should be performed in three key areas.
 - i. Ownership and control of the IP assets.
 - ii. Strength and value of the IP assets.
 - iii. Potential liability for infringement.
- b. Ownership and control-related due diligence.
 - i. Key issues to be evaluated with respect to all IP assets when conducting ownership and control-related due diligence.

- (A) Have all registrations relating to the applicable IP asset been obtained or applied for, and are they up-to-date in the relevant filing offices in the United States and abroad?
 - (B) Does a clear chain of title to the IP asset exist from the inventor, author, and/or previous owner to the target company?
 - (C) In instances where an IP asset has been assigned, do proper assignment documents recorded in the public records exist?
 - (D) Do any security interests, liens, or other forms of encumbrances exist relating to any of the IP assets?
- ii. Useful actions to be performed when conducting ownership and control-related due diligence.
- (A) Review the pertinent patent, trademark, and copyright office files and other public records. When doing so, verify that the target company possesses valid ownership of the applications or registrations.
 - (B) Verify the chain of title for all applicable IP assets to confirm that all necessary assignments are in place and have been filed or recorded with the applicable government agencies. Such verification of the existence of proper assignments from all applicable inventors relating to patents is critical.
 - (C) Check the public records to determine whether any encumbrances exist relating to any of the IP assets (e.g., security interests or liens). With respect to IP assets in the United States, a separate UCC search for each IP asset should be performed.
 - (D) Review any trade secret policies and procedures utilized by the target company, as well as all agreements to recognize and maintain confidentiality.
 - (E) Identify any IP assets that may be subject to government regulations or restrictions, and evaluate what effects, if any, such regulations or restrictions may have on the acquirer's planned use of the applicable IP asset.
 - (F) Determine whether the target company has any unregistered rights relating to any IP assets (e.g., unregistered trademarks or copyrights for items in the United States).
- c. Strength and value-related due diligence.

- i. Critical issues to be evaluated when conducting strength and value-related due diligence pertaining to key IP assets essential to the acquirer's business plan.
 - (A) With respect to each key patent, how strong is its validity and the quality of its claims?
 - (B) Regarding important trademarks and copyrights, are there any restrictions on the ownership and use of the assets, including any geographic restrictions or any restrictions on the transferability to the acquirer?
 - (C) With respect to trade secrets, how extensive and successful have the target company's measures to keep the proprietary information secret?
- ii. Useful actions to be performed when conducting strength and value-related due diligence.
 - (A) For each key patent, request and review the target company's files relating to the patent's prior art, patentability, validity, and right to use searches. Based on such review, conduct additional prior art search and analyses for validity and scope, and obtain and review the prosecution history of the patent from the U.S. Patent and Trademark Office ("USPTO") and any relevant foreign patent offices, as applicable.
 - (B) For each important trademarks, request and review the target company's files relating to clearance searches conducted by target for the trademark. Based on such review, conduct independent searches for exclusive right to the use the trademark, and obtain and review the prosecution history from the USPTO and any relevant foreign patent offices, as applicable.
 - (C) For important trade secrets, review the specific policies and procedures utilized by the target company to protect those trade secrets, as well as all agreements to recognize and maintain confidentiality relating to them.
 - (D) Review all license agreements and contracts relating to key IP rights licensed in or out of the target company for such issues as exclusivity, field-of-use restrictions, geographic restrictions, and transferability to the acquirer.
 - (E) Review all settlement agreements relating to critical IP assets for any restrictions on the ownership and/or use of the assets.

- d. Potential liability-related due diligence.
 - i. Critical issues to be evaluated when conducting potential liability-related due diligence.
 - (A) Is the target company infringing the IP rights of any third parties?
 - (B) Does the target company otherwise have any risk exposure due to allegations of IP infringement?
 - (C) Is there or has there been any IP-related litigation involving the target company?
 - ii. Useful actions to be performed when conducting potential liability-related due diligence.
 - (A) Identify all actual or threatened patent-related litigation against the target company or initiated by the target company.
 - (B) Review all right to use opinions relating to the target company's patents.
 - (C) Identify all actual or threatened copyright-related litigation against the target company or initiated by the target company.
 - (D) Identify all actual or threatened trademark-related litigation against the target company or initiated by the target company.
 - (E) Identify all actual or threatened trade secret-related litigation against the target company or initiated by the target company.
 - (F) Identify any trademarks or copyrights that have been recorded with U.S. Customs or similar foreign customs authorities.
 - (G) Identify trademark-related opposition or cancellation proceedings initiated against the target company by the USPTO or similar foreign proceedings.
 - (H) Identify any pending or potential domain name disputes.
 - (I) Review and determine sufficiency of procedures for quality control over licensee use of trademarks.

(J) Evaluate the target company's procedures for obtaining copyright clearance and otherwise avoiding the infringement of other's IP rights.

(K) Evaluate the adequacy of insurance coverage against IP infringement and false advertising claims.

5. Key Issues from an In-House Counsel's Perspective.

- a. Hiring outside counsel: Local vs. non-local counsel.
- b. Preparing and sticking to budgets: How to manage outside counsel spend.
- c. Bridging the gap: Interfacing between in-house clients and outside counsel and managing expectations from both sides.
- d. Organizing the team: Interfacing with Finance, Tax, Marketing, HR, Senior Management, M&A Team, Risk Management, Sales, Operations, IT, etc.
- e. Due Diligence and NDA: How to balance due diligence and NDA – risks vs. opportunities.
- f. Negotiating the SPA/APA: Keeping in mind short term and long term goals
- g. Speed: How to generate and maintain momentum.
- h. Organizing a closing: The 5Ws and how to ensure a smooth and timely close.
- i. Post-closing deal requirements: Decide in advance how you plan to communicate post-closing.
- j. Integrating the new entity: Keys to success.

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APPENDIX A

Caveat Emptor: International Mergers and Acquisitions

Sponsored by International Practice, Antitrust Law, Business Law, Corporate Counsel, and Intellectual Property Sections

**Friday, June 19, 2015
Hilton Oceanfront Hotel - 31st Street & Atlantic Avenue
1:30 pm – 3:30 pm
Peacock Ballroom B&C
(2.0 Hours)**

SPEAKER BIOS

Stephen Hanson - Staff Chair, Committee on Foreign Investment in the United States, Washington, DC. As Staff Chair of CFIUS, an inter-agency committee authorized to review transactions that could result in control of a U.S. business by a foreign person, Mr. Hanson coordinates national security reviews of select foreign direct investments into the United States.

Robert J. Barrett - Assistant Corporate Counsel, Degremont Technologies N.A., Richmond, VA. In his position with Degremont, a national water treatment company, Mr. Barrett focuses on legal issues relating to commercial contract review and negotiations, mergers and acquisitions, litigation management, intellectual property, and human resources.

J. Brent Justus - McGuire Woods LLP, Richmond, VA. Mr. Justus focuses his practice on antitrust and trade regulation, class action litigation, and complex commercial litigation. Mr. Justus has worked extensively on merger investigations involving both domestic and European companies and has supervised the preparation of hundreds of Hart-Scott-Rodino premerger notification filings.

Moderator:

Geoffrey M. Goodale - Trade Law Advisors, PLLC, Washington, DC; Chair, International Practice Section. Mr. Goodale's practice focuses on export controls, economic sanctions, cybersecurity, import compliance, intellectual property rights protection, and international investment. He regularly counsel clients on trade-related due diligence matters, including with respect to investment review proceedings before CFIUS. By appointment of the Chief Judge of the U.S. Court of International Trade (CIT), Geoff is a member of the CIT Advisory Committee on Rules. He also serves as Vice-Chair of the ABA Section of International Law's Export Controls and Economic Sanctions Committee and as a Senior Advisor to the Section's Customs Law Committee and International Trade Committee. In addition, he is the current Chair of the Virginia State Bar's International Practice Section and the Immediate Past Chair of the D.C. Bar's International Law Section. He received his J.D. from the George Washington University Law School, where he was a Dean's Fellow and Notes Editor for the *AIPLA QUARTERLY JOURNAL*. He obtained his B.A. in Russian Studies and Government, with Honors, and his M.A. in Government from the College of William and Mary. Prior to forming Trade Law Advisors, Mr. Goodale served as Senior Counsel in the international trade practice group of an Am Law 100 law firm.

APPENDIX B



CFIUS Reform: The Foreign Investment & National Security Act of 2007 (FINSA)

FINSA became effective October 24, 2007, after being passed with strong bipartisan and Administration support. The statute amends Section 721 of the Defense Production Act, which was enacted in 1988 to provide for national security reviews of foreign investments. Pre-FINSA, the Committee on Foreign Investment in the United States (CFIUS) implemented Section 721 solely per Executive Order 11858.

FINSA maintains the narrow scope and efficient timeline of CFIUS's review process

- *Scope*: Focuses solely on genuine national security concerns – not broader policy interests – posed by mergers, acquisitions, and takeovers that could result in foreign control of a U.S. business.
- *Timeline*: CFIUS must conclude a review in 30 days and an investigation, if needed, in a subsequent 45 days. In the rare case where CFIUS requests his decision, including on whether to prohibit or suspend a transaction, the President has 15 days to act.

Expands CFIUS membership:

- *New Members*: Adds Secretary of Energy and allows the President to add additional members.
- *Ex Officio Members*: Director of National Intelligence provides CFIUS independent intelligence analysis, and Labor Secretary advises on mitigation conformity with U.S. employment law. Neither participates in policy decisions.

Increases senior-level accountability within CFIUS:

- *Lead Agency*: Treasury, as CFIUS chair, must designate, as appropriate, an agency or agencies with lead responsibility for each covered transaction.
- *Investigations*: To conclude action on transactions that involve (1) foreign government control or (2) foreign control of critical infrastructure that CFIUS has determined “could impair” national security, if that risk has been mitigated, the Secretary or Deputy Secretary of the Treasury and of the lead agency must find the transaction “will not impair” national security.
- *Clearance*: At no lower than the Assistant Secretary level, Treasury and the lead agency must certify to Congress that CFIUS had “no unresolved national security concerns” in any review it concludes. For concluded investigations, the certification must be at the Secretary or Deputy Secretary levels.
- *Congress*: In addition to the clearance certifications for each concluded case (described above), CFIUS must give Congress confidential briefings upon request and issue an extensive annual report. These communications with Congress come only after action under Section 721 has been concluded.

Adds to the illustrative list of national security factors for CFIUS and the President to consider

Other additions and changes made by FINSA:

- *Risk Mitigation*: Mitigation agreements or conditions must be based on a “risk-based analysis.”
- *Enforcement and Tracking*: Requires CFIUS to monitor and enforce compliance with mitigation measures and to track withdrawn notices. Allows for imposition of civil penalties.
- *Reopening of Reviews*: Allows CFIUS to reopen a review if the parties made a material omission or misstatement to CFIUS, or if the parties intentionally and materially breach a mitigation agreement. Before reopening, CFIUS must agree no other remedy is sufficient.
- *Filer Certifications*: Filers must certify that filings are accurate, complete, and comply with the law.
- *Confidentiality*: Imposes on Congress, with regard to briefings from CFIUS, the same confidentiality rules that bind CFIUS with regard to all information provided by filers.

For additional information on CFIUS, please consult <http://www.treas.gov/offices/international-affairs/cfius/>.

APPENDIX C



CFIUS Reform: Amendment of Executive Order 11858 on January 23, 2008

Executive Order 11858 of May 7, 1975, as amended, elaborates on Executive Branch rules for the Committee on Foreign Investment in the United States (CFIUS) and implements Section 721 of the Defense Production Act (Section 721). Following enactment of the Foreign Investment and National Security Act of 2007 (FINSAs), the President issued Executive Order 13456 on January 23, 2008, to amend Executive Order 11858. The amendments to Executive Order 11858 reflect the United States' strong and continuing commitment to safeguarding U.S. national security while maintaining an open investment climate.

Expands CFIUS Membership Beyond Those Members Listed In Section 721:

- *Non-Statutory Members*: The United States Trade Representative and Director of the Office of Science and Technology Policy are added as full members. The heads of the Office of Management and Budget, Council of Economic Advisers, and National Economic Council, and of the National Security Council and Homeland Security Council staff are added to observe, participate in, and, as appropriate, report to the President on CFIUS's activities.
- *Case-by-Case Members*: The President or the Chair may add relevant members on a case-by-case basis. (FINSAs also authorizes the Secretary of the Treasury, as CFIUS chair, to consult with other agency heads as appropriate in particular cases.)

Ensures Efficient, Robust Reviews:

- *CFIUS Chair*: Defines the Treasury's duties vis-à-vis lead agencies and other members, including acting as the point of contact with outside parties, designating lead agencies for any part of a case, and reviewing material action proposed by a lead agency in order to ensure coordination within CFIUS and provide CFIUS's direction.
- *National Security Reviews*: Ensures that all CFIUS members are able to participate fully in every CFIUS review, specifying that any CFIUS member can trigger an investigation if it believes a transaction under review threatens to impair national security and that threat has not been mitigated.
- *Presidential Decisions*: Provides mechanism for CFIUS to request that the President decide whether a transaction should be suspended or prohibited – which only he may do – where a transaction threatens to impair the national security of the United States and other laws, besides Section 721 and the International Emergency Economic Powers Act, are inadequate or inappropriate to address that threat.

Imposes Additional Analytical and Procedural Disciplines on CFIUS Agencies:

- *Risk-Based Analysis*: Risk mitigation provisions must be justified by a written analysis of the national security risk posed by a transaction, and CFIUS must agree that they are justified.
- *Existing Laws*: Limits CFIUS to seeking risk mitigation agreements or conditions only when other laws besides Section 721 are inadequate and, except in extraordinary circumstances, prohibits the use of mitigation agreements to require a party's recognition of existing legal authorities. Also prohibits CFIUS agencies from using CFIUS's authorities to gain leverage over the parties with regard to enforcement of the agencies' existing legal authorities outside the CFIUS process.

For additional information on CFIUS, please consult [<http://www.treas.gov/offices/international-affairs/cfius/>]

APPENDIX D



CFIUS Reform: Final Regulations Issued on November 14, 2008

The U.S. Treasury Department, on behalf of the Committee on Foreign Investment in the United States (CFIUS), issued final regulations governing CFIUS on November 14, 2008. The regulations implement Section 721 of the Defense Production Act of 1950, as amended by the Foreign Investment and National Security Act of 2007 (Section 721). The regulations also codify improvements to the CFIUS process informed by seventeen years of practice. Issued in proposed form on April 21, 2008, the final regulations reflect CFIUS's careful consideration of all comments received during the public comment period, as described in the discussion that precedes the regulatory text. By increasing clarity and transparency and ensuring that the CFIUS process is efficient, the regulations reinforce the United States' longstanding commitment to open investment.

Regulations Clarify What Constitutes a “Covered Transaction”:

- Only “covered transactions” are subject to CFIUS review under Section 721.
- *Covered transaction*: Any transaction proposed or pending after August 23, 1988, by or with any foreign person, which could result in control of a U.S. business by a foreign person.
- *“Greenfield” investment*: Greenfield, or start-up investment, is not covered.
- *Asset acquisition*: Not a covered transaction if the assets acquired by a foreign person do not constitute a “U.S. business.”
- *Long-term lease*: May be a covered transaction only if a foreign lessee makes substantially all business decisions concerning operation of a leased U.S. business, as if it were the owner.
- *Lending transaction*: Not a covered transaction unless the foreign person acquires financial or governance rights characteristic of an equity investment, but not of a loan. Imminent default giving a foreign person actual control of collateral that constitutes a U.S. business is a covered transaction – but lenders in the ordinary course may qualify for an exception.
- *Incremental acquisition*: After CFIUS concludes action on a covered transaction, the foreign person's acquisition of additional interest in a U.S. business is not a new covered transaction.

Regulations Clarify the Key Concept of “Control”:

- *Functional test*: CFIUS will continue to consider all relevant facts and circumstances, rather than applying a bright-line test to determine whether a transaction results in foreign control.
 - *Important matters*: Expand the illustrative list of “important matters.” Control is defined as the “power, direct or indirect, whether or not exercised ... to determine, direct, or decide important matters affecting an entity.”
 - *Private equity*: Add examples to clarify that certain structures create ownership interests but not control, clarifying that CFIUS focuses on person's powers, not transaction form.
 - *Joint ventures*: Revise treatment of joint ventures to ensure that using a JV to acquire a U.S. business is a covered transaction to the same extent as a direct acquisition.
 - *Passive investment*: Clarify that there is no automatic exclusion for acquisitions of ten percent or less. That rule applies only if the investor is passive, maintains that sole intent, and takes no action to the contrary.



- Minority shareholder protections: Identify negative rights that do not, in themselves, confer control, and provide that other rights held by minority shareholders also could be found not to confer control on a case-by-case basis.
- Influence versus control: Add new examples and expand others to clarify the difference between “control” and mere “influence.”
- Aggregating interests: Clarify when CFIUS, in determining control, may consider relationships or arrangements to act in concert between persons.
- Convertible voting instruments: Identify factors CFIUS takes into account in determining whether to consider, at the time of acquisition or at a later date, the rights a foreign person will receive upon conversion of convertible voting instruments, for purposes of assessing control.

Regulations Clarify Additional Aspects of the CFIUS Process and Ensure Efficient Review:

- Pre-filing: Encourage pre-filing consultations to aid parties in preparing notices and to ensure efficient reviews.
- Clear timelines: Ensure an efficient process by requiring prompt action throughout the review process by the Staff Chair and by parties to transactions, within the context of the strict deadlines established by statute for reviews (30 days) and investigations (45 days).
- Contents of notice: Increase transparency by requiring in a voluntary notice the types of information CFIUS requests in practice, which also aids efficient review by CFIUS.
- Confidentiality: Explicitly extend confidential treatment to information pre-filed with CFIUS, including if no notice is ultimately filed.
- Penalties: Set a limit on civil penalties and provide the right to petition for reconsideration of any penalty, which may be imposed upon any person who makes a material misstatement or omission in a notice filed with CFIUS, makes a false certification to CFIUS, or breaches a mitigation agreement.
- Secretary of Labor: Define the role of the Secretary of Labor as advising on whether mitigation terms would violate U.S. employment laws.
- Critical infrastructure: Clarify that CFIUS considers the particular assets involved in a transaction, rather than designating whole classes of assets as “critical infrastructure.”

For a link to the final regulations, as well as additional information on CFIUS, please consult <http://www.treas.gov/offices/international-affairs/cfius/>.

APPENDIX E



INTELLIGENCE

UNDER SECRETARY OF DEFENSE
5000 DEFENSE PENTAGON
WASHINGTON, D.C. 20301-5000

September 02, 2009
Incorporating Change 6, January 9, 2014

MEMORANDUM FOR SECRETARIES OF THE MILITARY DEPARTMENTS
CHAIRMAN OF THE JOINT CHIEFS OF STAFF
UNDER SECRETARIES OF DEFENSE
DEPUTY CHIEF MANAGEMENT OFFICER
ASSISTANT SECRETARIES OF DEFENSE
GENERAL COUNSEL OF THE DEPARTMENT OF DEFENSE
DIRECTOR, OPERATIONAL TEST AND EVALUATION
INSPECTOR GENERAL OF THE DEPARTMENT OF DEFENSE
ASSISTANTS TO THE SECRETARY OF DEFENSE
DIRECTOR, ADMINISTRATION AND MANAGEMENT
DIRECTOR, COST ASSESSMENT AND PROGRAM
EVALUATION
DIRECTOR, NET ASSESSMENT
DIRECTORS OF THE DEFENSE AGENCIES
DIRECTORS OF THE DoD FIELD ACTIVITIES

SUBJECT: Directive-Type Memorandum (DTM) 09-019 - "Policy Guidance for Foreign Ownership, Control, or Influence (FOCI)"

References: Attachment 1

Purpose. This DTM replaces policy on foreign ownership, control, or influence (FOCI) contained in section C2.2 of DoD 5220.22-R (Reference (a)) in accordance with the authority in DoD Directive 5143.01 (Reference (b)). This DTM is effective immediately. After appropriate coordination, it shall be reissued as part of Volume 3 of DoD 5220.22-M (Reference (c)) the National Industrial Security Program (NISP) Operating Manual, not later than November 30, 2014.

Applicability. This DTM applies to:

- OSD, the Military Departments, the Office of the Chairman of the Joint Chiefs of Staff and the Joint Staff, the Combatant Commands, the Office of the Inspector General of the Department of Defense, the Defense Agencies, the DoD Field Activities, and all other organizational entities within the Department of Defense (hereafter referred to collectively as the "DoD Components").

- U.S. Government (USG) departments and agencies listed in paragraph 1-103.b. of Reference (c). In accordance with section 202 of Executive Order 12829 (Reference (d)) and paragraph 3.2. of DoD Directive 5220.22 (Reference (e)), the Secretary of Defense has entered into agreements with those USG departments and agencies for the purpose of rendering industrial security services. In these agreements, the head of the USG department or agency agrees to comply with the provisions of Reference (a) and changes thereto, such as this DTM. DoD Components and these non-DoD agencies are collectively referred to as “Government Contracting Activities” (GCAs) within this interim guidance.
- This DTM does not levy requirements on companies. Cleared companies and companies in process for facility security clearance are subject to the requirements of Reference (c) and other security requirements of their contracts.
- Nothing contained in this DTM shall affect the authority of a GCA to limit, deny, or revoke access to classified information under its statutory, regulatory, or contractual jurisdiction.

Policy. It is DoD policy that:

- The Department of Defense shall allow foreign investment consistent with the national security interests of the United States.
- DoD FOCI procedures shall be used to protect against foreign interests:
1) gaining unauthorized access to classified, all Communications Security (COMSEC) (classified or unclassified), or export-controlled information; 2) adversely affecting the performance of classified contracts; or
3) undermining U.S. security and export controls.

Responsibilities

- The Under Secretary of Defense for Intelligence (USD(I)) shall oversee policy and management of the National Industrial Security Program (NISP), to include FOCI matters.
- The Director, Defense Security Service (DSS), under the authority, direction, and control of the USD(I), shall make FOCI determinations for U.S. companies cleared or under consideration for a facility clearance (FCL) under the NISP. The Director, DSS, may delegate this responsibility

within DSS. FOCI determinations shall be made on a case-by-case basis. In this regard, the Director, DSS, shall:

- Collect information necessary to examine the source, nature, and extent of a company's ownership, control, or influence by foreign interests.
 - Determine, on behalf of the GCAs, whether a U.S. company is under FOCI to such a degree that the granting of an FCL would be inconsistent with the national interest.
 - Determine the security measures necessary to mitigate FOCI and make recommendations to the U.S. company and to those GCAs with an official interest in the matter.
 - Determine, initially and on a continuing basis, the U.S. company's eligibility for an FCL.
- The Heads of the GCAs shall ensure GCA compliance with applicable procedures identified in this DTM.

Procedures. Attachment 2 provides procedures for complying with this DTM.

Releasability. UNLIMITED. This DTM is approved for public release and is available on the Internet from the DoD Issuances Website at <http://www.dtic.mil/whs/directives>.


James R. Clapper, Jr.

Attachments:
As stated

ATTACHMENT 1

REFERENCES

- (a) DoD 5220.22-R, "Industrial Security Regulation," December 4, 1985
- (b) DoD Directive 5143.01, "Under Secretary of Defense for Intelligence (USD(I)),
November 23, 2005
- (c) DoD 5220.22-M, "National Industrial Security Program Operating Manual,"
February 28, 2006
- (d) Executive Order 12829, "National Industrial Security Program," January 6, 1993, as
amended
- (e) DoD Directive 5220.22, "National Industrial Security Program,"
September 27, 2004
- (f) Section 2536 of Title 10, United States Code
- (g) Subpart 209.104-1 of the Defense Federal Acquisition Regulation Supplement
(DFARS), as amended
- (h) Section 2170 of Title 50, United States Code Appendix, as amended

ATTACHMENT 2

FOCI PROCEDURES

1. GENERAL. This attachment provides guidance for and establishes procedures concerning the initial or continued FCL eligibility of U.S. companies with foreign involvement; provides criteria for determining whether U.S. companies are under FOCI; prescribes responsibilities in FOCI matters; and outlines security measures that may be considered to mitigate the effects of FOCI to an acceptable level. As stated in Reference (c), and in accordance with Reference (d):

a. The Secretary of Defense serves as the USG Executive Agent for inspecting and monitoring the contractors, licensees, and grantees who require or will require access to, or who store or will store classified information.

b. The USG reserves the discretionary authority, and has the obligation, to impose unilaterally any security method, safeguard, or restriction it believes necessary to ensure that unauthorized access to classified information is effectively precluded and that performance of classified contracts, as defined in Reference (c), is not adversely affected by FOCI.

2. PROCEDURES

a. Criteria. A U.S. company is considered to be under FOCI whenever a foreign interest has the power, direct or indirect (whether or not exercised, and whether or not exercisable through the ownership of the U.S. company's securities, by contractual arrangements or other means), to direct or decide matters affecting the management or operations of the company in a manner that may result in unauthorized access to classified information or may adversely affect the performance of classified contracts.

b. FOCI Analysis. FOCI analysis is a critical aspect of evaluating previously uncleared companies for FCLs and also in determining continuing eligibility of currently cleared companies for FCLs.

(1) A currently uncleared company determined to be under FOCI is ineligible for an FCL unless and until security measures have been put in place to mitigate FOCI.

(2) In making a determination as to whether a company is under FOCI, DSS shall consider the information provided by the cleared company or its parent entity on the Standard Form (SF) 328, "Certificate Pertaining to Foreign Interests," and any

other relevant information. Depending on specific circumstances (e.g., extensive minority foreign ownership at a cleared subsidiary in the corporate family), DSS may request one or more of the legal entities that make up a corporate family to submit individual SF 328s and will determine the appropriate mitigation instrument(s) that must be put in place.

(3) When a company has been determined to be under FOCI, the primary consideration shall be the safeguarding of classified information. DSS is responsible for taking whatever interim action is necessary to safeguard classified information, in coordination with other affected agencies as appropriate.

(4) When a merger, sale, or acquisition involving a cleared U.S. company is finalized prior to having an acceptable mitigation agreement in place, DSS shall invalidate any existing FCL until such time as DSS determines that the company has submitted an acceptable FOCI action plan in accordance with paragraph 2-303. of Reference (c). Invalidation renders the company ineligible to receive new classified material or to bid on new classified contracts. However, if the affected GCA determines that continued access to classified material is required, DSS may continue the FCL so long as there is no indication that classified information is at risk of compromise. If there is any concern that classified information is at risk of compromise due to the FOCI and security measures cannot be taken to remove the possibility of unauthorized access to classified information, DSS shall take action to terminate the FCL.

(5) Changed conditions, such as a change in ownership, indebtedness, or the foreign intelligence threat, may justify certain adjustments to the security terms under which a company is cleared or, alternatively, require the use of a particular FOCI mitigation arrangement. If a changed condition is of sufficient significance, it might also result in a determination that a company is no longer considered to be under FOCI or that a company is no longer eligible for an FCL because FOCI is not, or cannot be, in the view of DSS, appropriately mitigated.

(6) If the company determined to be under FOCI does not have possession of classified material and does not have a current or pending requirement for access to classified information, DSS shall administratively terminate the FCL.

c. Determining the Appropriate FOCI Mitigation Measures

(1) If DSS determines that a company is under FOCI, DSS shall determine the extent and manner to which the FOCI may result in unauthorized access to classified information and the type of actions, if any, that would be necessary to mitigate the associated risks to a level deemed acceptable to DSS. These factors must be considered in the aggregate with regard to the foreign interest that is the source of the FOCI, the country or countries in which the foreign interest is domiciled and has its principal place

of business (if not in the country of domicile), and any other foreign country that is identified by DSS because it is a substantial source of the revenue for, or otherwise has significant ties to, the foreign interest. DSS shall consider:

(a) Record of economic and government espionage against U.S. targets.

(b) Record of enforcement and/or engagement in unauthorized technology transfer.

(c) Record of compliance with pertinent U.S. laws, regulations, and contracts.

(d) The type and sensitivity of the information that shall be accessed.

(e) The source, nature, and extent of FOCI, including, but not limited to, whether foreign persons hold a majority or substantial minority position in the company, taking into consideration the immediate, intermediate, and ultimate parent companies of the company.

(f) The nature of any bilateral and multilateral security and information exchange agreements that may pertain.

(g) Ownership or control, in whole or in part, by a foreign government.

(h) Any other factor that indicates or demonstrates a capability on the part of foreign interests to control or influence the operations or management of the business organization concerned.

(2) As part of its FOCI assessment and evaluation of any mitigation plan, DSS shall also obtain and consider counterintelligence and technology transfer risk assessments from all appropriate USG sources. DSS shall request the assessments as soon as practicable, for the cleared company itself and for all business entities in the company's ownership chain.

(3) If a company disputes a DSS determination that the company is under FOCI, or disputes the DSS determination regarding the types of actions necessary to mitigate the FOCI, the company may appeal in writing those determinations to the Director, DSS, for a final agency decision no later than 30 calendar days after receipt of written notification of the DSS decision. The company must identify the specific relief sought and grounds for that relief in its appeal. The Director, DSS, may request

additional information from the company to make a final decision. DSS shall respond to appeals within 30 calendar days, either with a decision or an estimate as to when a decision will be rendered.

d. FOCI Action Plans

(1) The Department of Defense recognizes that foreign ownership concerns may arise in a variety of other circumstances, all of which cannot be listed here. In FOCI cases involving foreign ownership, DSS shall advise and consult with the appropriate GCAs, including those with special security needs, regarding the required mitigation method. When DSS determines that a company may be ineligible for an FCL by virtue of FOCI, or that additional action by the company may be necessary to mitigate the FOCI or associated risks, DSS shall promptly notify the company and require it to submit a FOCI action plan to DSS within 30 calendar days of the notification. In addition, company management shall be advised that failure to submit the requested plan within the prescribed period of time will result in termination of FCL processing action or initiation of action to revoke an existing FCL, as applicable.

(2) In instances where the identification of a foreign owner cannot be adequately ascertained (e.g., the participating investors in a foreign investment or hedge fund cannot be identified), DSS may make a determination that the company is not eligible for an FCL.

(3) DSS shall review the acceptability of the FOCI action plan submitted by a company. DSS shall consider the FOCI action plan itself, the factors identified in paragraph 2.c.(1) of this attachment, and any threat or risk assessments or other relevant information received by DSS. If an action plan is determined to be unacceptable, DSS is authorized to recommend and negotiate an acceptable action plan including but not limited to the measures identified in paragraphs 2.d.(4) and 2.d.(5) of this attachment.

(4) When factors related to foreign control or influence are present, but not those related to ownership, the plan must provide positive measures that assure that the foreign interest can be effectively denied access to classified information and cannot otherwise adversely affect performance on classified contracts. In accordance with paragraph 2-302.c. of Reference (c), non-exclusive examples of such measures include:

(a) Adoption of special board resolutions.

(b) Assignment of specific oversight duties and responsibilities to independent board members.

(c) Formulation of special executive-level security committees to consider and oversee matters that affect the performance of classified contracts.

- (d) The appointment of a technology control officer.
- (e) Modification or termination of loan agreements, contracts, and other understandings with foreign interests.
- (f) Diversification or reduction of foreign-source income.
- (g) Demonstration of financial viability independent of foreign interests.
- (h) Elimination or resolution of problem debt.
- (i) Physical or organizational separation of the company component performing on classified contracts.
- (j) Other actions that negate or mitigate foreign control or influence.

(5) FOCI concerns related to foreign ownership of a company or corporate family arise when a foreign interest has the ability, either directly or indirectly, whether exercised or exercisable, to control or influence the election or appointment of one or more members to the company's governing board (e.g., Board of Directors, Board of Managers, or Board of Trustees) or its equivalent, by any means. Some methods that may be applied to mitigate the risk of foreign ownership are described in paragraph 2-303. of Reference (c). While these methods are mentioned in relation to specific ownership and control thresholds, they should not be interpreted as DoD policy to pre-determine or select a certain mitigation plan without regard for the overall risk assessment.

(a) Board Resolution, when a foreign interest does not own voting interests sufficient to elect, or otherwise is not entitled to representation on the company's governing board. In such circumstances, the effects of foreign ownership will ordinarily be mitigated by a resolution of the board of directors whereby the cleared firm recognizes the elements of FOCI and acknowledges its continuing obligations under DD Form 441, "Department of Defense Security Agreement." The resolution shall identify the foreign shareholders and their representatives, if any, and note the extent of foreign ownership, including a certification that the foreign shareholders and their representatives will not require, will not have, and can be effectively excluded from access to all classified information in the possession of the cleared facility, and will not be permitted to occupy positions that may enable them to influence the organization's policies and practices in the performance of classified contracts. Copies of such resolutions shall be furnished to all board members and principal management officials.

(b) Security Control Agreement (SCA), when a foreign interest does not effectively own or control a company or corporate family but is entitled to representation on the company's board. U.S. citizen(s) will serve as Outside Director(s), as defined in paragraph 2-305. of Reference (c).

(c) Special Security Agreement (SSA), when a foreign interest effectively owns or controls a company or corporate family. If a GCA requires a company cleared under an SSA to have access to proscribed information, the GCA shall be required to complete a NID to confirm that disclosure of such information will not harm the national security interests of the United States. U.S. citizens will serve as Outside Directors. Proscribed information includes Top Secret (TS); COMSEC material, excluding controlled cryptographic items when unkeyed or utilized with unclassified keys; Restricted Data (RD); Special Access Program (SAP); and Sensitive Compartmented Information (SCI). Access to the proscribed information in this subparagraph shall not be granted without the approval of the agency with control jurisdiction (e.g., National Security Agency (NSA) for COMSEC, whether the COMSEC is proscribed information or not; the Office of the Director of National Intelligence (ODNI) for SCI; and the Department of Energy (DOE) for RD) in accordance with its policies.

(d) Voting Trust or Proxy Agreement, when a foreign interest effectively owns or controls a company or corporate family. Under either the Voting Trust or Proxy Agreement arrangement, the foreign owner relinquishes most rights associated with ownership of the company to cleared U.S. citizens approved by the USG. Under a Voting Trust Agreement, the foreign owner transfers legal title in the company to the trustees. Under a Proxy Agreement, the foreign owner's voting rights are conveyed to the proxy holders. Neither arrangement imposes any restrictions on the company's eligibility to have access to classified information or to compete for classified contracts. Both arrangements can effectively negate foreign ownership and control and for purposes of section 2536 of title 10, United States Code (Reference (f)), both arrangements can also effectively negate foreign government control (see paragraph 2.f. of this attachment). DSS reserves the discretion to deny a proposed Voting Trust or Proxy Agreement.

(6) Under all methods of FOCI mitigation, management positions requiring personnel security clearances in conjunction with the FCL must be filled by eligible U.S. citizens residing in the United States.

(7) When a FOCI mitigation agreement is put in place at a cleared company, the agreement may specify that the entire agreement, or that particular provisions of the agreement (e.g., the provisions restricting unauthorized access to classified information and unclassified export-controlled information and the provisions of the visitation policy) shall apply to and shall be made binding upon all present and

future subsidiaries of the company. If a subsidiary requires and is eligible for an FCL at the TS level, the company executing the FOCI mitigation agreement and any intermediate parents must be formally excluded from TS access unless they have their own requirement and are otherwise eligible for TS access.

(8) DSS shall provide a copy of the DSS FOCI assessment and proposed FOCI mitigation plan to the GCAs with an interest in the company or corporate family. In the absence of written objections (signed at the Program Executive Office level or higher) from GCAs with an interest in the company or corporate family, DSS may proceed with implementation of what DSS considers in its discretion to be an acceptable FOCI mitigation plan based on available information.

(9) The USD(I) will approve templates for those FOCI mitigation agreements identified in paragraph 2.d.(5) of this attachment. DSS may propose changes to the contents of these template FOCI mitigation agreements. DSS may tailor non-substantive provisions of the template agreement for any particular FOCI case without further approval from the USD(I), provided DSS notifies the Security Directorate, Office of the USD(I) (hereafter referred to as the OUSD(I) Security Directorate) of the deviation from the template.

e. NID. The requirement for NIDs applies equally to new contracts to be issued to companies already cleared under SSAs as well as existing contracts when cleared companies are acquired by foreign interests and an SSA is the proposed mitigation. Upon notification from DSS of the pending merger or acquisition by a foreign interest of a cleared company performing on a contract that requires access to proscribed information, or other transaction or event that would cause the cleared company to be under FOCI, the GCA shall review the FOCI action plan proposed by the company. If the company is proposing to use an SSA to mitigate FOCI, DSS shall advise the GCA of the need for a NID, and the GCA shall determine whether a favorable NID will be issued. (See paragraph 2.c.(1) of this attachment for FOCI factors which a GCA may consider when contemplating a NID.) If the GCA determines that a favorable NID is not warranted, the GCA shall contact DSS to address the acceptability of the proposed SSA as a means to mitigate FOCI.

(1) NIDs can be program, project, or contract specific. For program and project NIDs, a separate NID is not required for each contract. DSS may require the GCA to identify all contracts affected by the NID. The NID decision shall be made at the GCA's Program Executive Office level.

(2) The GCA shall provide the NID to DSS. If the NID is not specific to a single program, project, or contract (i.e., a blanket NID), the GCA shall also forward a copy of the NID to the OUSD(I) Security Directorate.

(3) If the proscribed information is under the classification or control jurisdiction of a USG department or agency other than the GCA (e.g., NSA for COMSEC, the ODNI for SCI, and the DOE for RD), the GCA shall advise that USG department or agency that its written concurrence is required before the GCA may issue a NID. The GCA shall forward the completed NID and any required concurrences to DSS.

(4) DSS shall not delay implementation of a FOCI action plan pending completion of a GCA's NID process as long as there is no indication that a NID will be denied. However, the company shall not have access to additional proscribed information until the GCA issues the NID.

(5) DSS shall not take action on a company's request to upgrade an existing SSA FCL to TS without a NID covering the prospective TS access.

f. Foreign Government Ownership or Control

(1) In accordance with Reference (f), the Department of Defense cannot award contracts involving access to proscribed information to a company effectively owned or controlled by a foreign government unless a waiver has been issued by the Secretary of Defense or designee as specified in paragraph 2.f.(3) of this attachment.

(2) A waiver is not required if a Proxy or Voting Trust Agreement is approved by DSS.

(3) The GCA shall determine, after consultation with DSS, if a waiver is needed in accordance with subpart 209.104-1 of the Defense Federal Acquisition Regulation Supplement (DFARS) (Reference (g)), and shall request the waiver from the USD(I). The GCA shall provide the USD(I) with supporting information, if requested by the USD(I) or designee. The GCA shall also forward a copy of the NID to the OUSD(I) Security Directorate.

(4) Upon receipt of the waiver, if issued, the GCA shall forward the approved waiver and the NID to DSS.

(5) If the USD(I) does not grant the waiver, the company may propose to DSS an appropriate Proxy or Voting Trust Agreement. Otherwise the company is not eligible for access to proscribed information.

g. Government Security Committee (GSC)

(1) Under a Voting Trust Agreement, Proxy Agreement, SSA, or SCA, DSS shall ensure that the cleared company establishes a permanent committee of its Board of Directors or similar body known as the GSC.

(2) DSS shall take measures to ensure that, in every case where a GSC is established as part of a FOCI mitigation measure, the GSC:

(a) Maintains policies and procedures to safeguard classified information and export-controlled unclassified information in the possession of the company.

(b) Ensures that the company complies with the DD Form 441 or its successor form, the FOCI mitigation agreement, applicable contract provisions regarding security, USG export control laws, and the NISP.

(3) In the case of an SSA, the number of Outside Directors must exceed the number of Inside Directors, defined in paragraph 2-303.c. of Reference (c). DSS shall determine if the Outside Directors should be a majority of the Board of Directors based on an assessment of security risk factors pertaining to the company's access to classified information. In the case of an SCA, DSS shall require the company to have at least one Outside Director. DSS may require more than one Outside Director for an SCA based on an assessment of security risk factors pertaining to the company's access to classified information.

(4) In the case where a company operating under an SSA is the parent of a company that has been provided access, pursuant to a NID or otherwise, to proscribed information by a GCA, some or all of the Outside Directors at the cleared parent company may be sponsored for eligibility for access to classified information. Access shall be at the level necessary for the Outside Director(s) to carry out their security or business responsibilities for oversight of the subsidiary company in accordance with Reference (c).

h. Technology Control Plans (TCPs). Under a Voting Trust, Proxy Agreement, SSA, or SCA, DSS will require the company to develop and implement a TCP. DSS shall be responsible for approving the TCP. The TCP must include a description of all security measures determined to be necessary to prevent the unauthorized disclosure of classified or export-controlled information. Although TCPs must be tailored to the specific circumstances of the company or corporate family to be effective, DSS may provide examples of TCPs for use by the company in creating its own plan.

i. Electronic Communications Plan (ECP). Under a Voting Trust, Proxy Agreement, SSA, or SCA, DSS will require the company to develop and implement an ECP applicable to the company's operations. DSS shall determine the needed extent of, and approve, the ECP. The ECP must include a detailed network description and configuration diagram that clearly delineates which networks will be shared and which will be protected from foreign access. The network description shall address firewalls,

remote administration, monitoring, maintenance, and separate e-mail servers, as appropriate.

j. Annual Review and Certification

(1) Annual Meeting. DSS shall meet at least annually with the GSCs of companies operating under a Voting Trust Agreement, Proxy Agreement, SSA, or SCA to review and discuss the purpose and effectiveness of the FOCI mitigation and other security arrangements; establish common understanding of the operating requirements and their implementation; answer questions from the GSC members; and provide guidance on matters related to FOCI mitigation and industrial security. These meetings shall also include an examination by DSS, with the participation of the Facility Security Officer and the GSC members, of:

(a) Acts of compliance or noncompliance with the approved security arrangement, standard rules, and applicable laws and regulations.

(b) Problems or impediments associated with the practical application or utility of the security arrangement.

(c) Questions as to whether security controls, practices, or procedures warrant adjustment.

(2) Annual Certification. For companies operating under a Voting Trust Agreement, Proxy Agreement, SSA, or SCA, DSS shall obtain from the Chair of the GSC an implementation and compliance report 1 year from the effective date of the agreement (and annually thereafter). DSS shall review the annual report; address, resolve, or refer, as appropriate, issues identified in the report; document the results of this review and any follow-up actions; and keep a copy of the report and documentation of related DSS actions on file for 15 years. The GSC's report must include:

(a) A detailed description of the manner in which the company is carrying out its obligations under the agreement.

(b) Changes to security procedures, implemented or proposed, and the reasons for those changes.

(c) A detailed description of any acts of noncompliance, whether inadvertent or intentional, with a discussion of steps that were taken to prevent such acts from recurring.

(d) Any changes or impending changes of senior management officials or key board members, including the reasons for the change.

(e) Any changes or impending changes in the organizational structure or ownership, including any acquisitions, mergers, or divestitures.

(f) Any other issues that could have a bearing on the effectiveness of the applicable agreement.

k. Changed Conditions

(1) DSS shall require that companies submit timely reports of changes to FOCI by DSS-designated means.

(2) Upon receipt of changes to the SF 328 from companies, DSS shall assess the changes to determine if they are material; if they require the imposition of FOCI mitigation where none existed before or modification of existing FOCI mitigation; or if they necessitate the termination of existing FOCI mitigation.

1. Limited FCL. Upon receipt of a request from a GCA, in accordance with paragraph 2-309. of Reference (c), DSS may issue a Limited FCL to a foreign owned company when FOCI mitigation is not feasible. A company that is issued a Limited FCL will normally not be required to have any FOCI mitigation measures in place, but is required to meet other provisions of Reference (c) on the protection of classified and export-controlled information. A Limited FCL may be granted under one of two conditions:

(1) The government of the foreign country from which the foreign ownership of the company is derived and the United States have entered into an Industrial Security Agreement, and the classified information to be disclosed to the company has been authorized for release to that foreign government in conformity with the U.S. National Disclosure Policy. Key management personnel (KMP) may be citizens of the country of ownership, if DSS is able to obtain a security assurance (i.e., assurance from the government of the country of citizenship that a KMP is eligible for access to classified information).

(2) An authorized official of the GCA certifies in writing that there is a compelling need to issue the Limited FCL and accepts the risk inherent in not mitigating the FOCI. The Limited FCL permits performance only on classified contracts issued by the GCA that sponsored the company for the Limited FCL. DSS shall verify a Limited FCL only to the sponsoring GCA.

m. Foreign Mergers, Acquisitions, and Takeovers and the Committee on Foreign Investment in the United States (CFIUS)

(1) The CFIUS, an interagency committee chaired by the Secretary of the Treasury, conducts reviews of proposed mergers, acquisitions, and takeovers of U.S. persons (i.e., any form of business entity) by foreign persons under section 721 of the Defense Production Act of 1950, section 2170 of title 50, United States Code Appendix, as amended (Reference (h)). A CFIUS review is a voluntary process that is normally initiated by companies involved in the transaction. During the review process, foreign and U.S. persons submit the transaction for review to CFIUS so that its impact on U.S. national security can be assessed by CFIUS member agencies.

(2) The process of reviewing any given acquisition involves several steps. Upon accepting a jointly filed notice of a covered transaction, CFIUS conducts an initial 30 calendar day review to determine whether the transaction presents national security considerations that warrant a full-scale second-stage investigation. If CFIUS determines that the transaction does not pose such concerns, the process ends with a determination notice to the parties that action pursuant to Reference (h) is concluded. If CFIUS determines that the acquisition may pose national security concerns, the review process continues with a 45 calendar day second-stage investigation period. If the transaction involves foreign government control of the acquired U.S. entity, the review automatically proceeds to the second-stage investigation unless CFIUS determines during the 30 calendar day review that the transaction does not impair U.S. national security. If concerns cannot be resolved, CFIUS member agencies may recommend to the President that the transaction be suspended or prohibited. The President then has 15 calendar days to decide what action to take, if any.

(3) The CFIUS review and the DSS industrial security review for FOCI are carried out in two parallel but separate processes with different time constraints and considerations. DSS shall review, adjudicate, and mitigate FOCI for companies that are also under CFIUS review on a priority basis and shall forward all relevant information to the OUSD(I) Security Directorate for a consolidated reply to the DoD CFIUS representative as follows:

(a) For any CFIUS transaction about which DSS is notified, by the tenth calendar day after the CFIUS filing DSS will advise Defense Technology Security Administration (DTSA) electronically, with a copy to the OUSD(I) Security Directorate, of the company's FCL status (e.g., no FCL, FCL in process, TS/Secret/Confidential FCL).

(b) If the company is cleared or in process for an FCL, DSS input is critical to the process of defining a DoD position on the CFIUS case. Therefore, for cleared and in-process companies, DSS will provide their input to the OUSD(I) Security Directorate on or before the DTSA-established suspense date for all DoD Components to submit their positions on the proposed transaction. DSS shall include:

1. Basic identification information for the cleared company, to include name, address, and commercial and government entity (CAGE) code.

2. FCL level.

3. Identification of current classified contracts, to include identification of GCAs and any requirement for access to proscribed information.

4. The nature and status of any discussions DSS has had with the cleared company or the foreign interest regarding proposed FOCI mitigation measures.

5. The DSS position regarding further CFIUS investigation (stated in a signed memorandum with rationale, if DSS is recommending further investigation).

6. Identification of any known security issues (e.g., marginal or unsatisfactory security rating, unresolved counterintelligence concerns, alleged export violations).

(4) If a transaction under CFIUS review would require consummation of new FOCI mitigation measures, DSS shall promptly advise the parties to the transaction and request that they submit to DSS a plan to mitigate FOCI.

(a) If it appears that an agreement cannot be reached on material terms of a FOCI action plan, or if the U.S. party to the proposed transaction fails to comply with the FOCI reporting requirements of Reference (c), DSS may recommend through the OUSD(I) Security Directorate a 45 calendar day investigation of the transaction to determine the effects on national security and to decide whether to recommend that the President take any action.

(b) If the proposed transaction involves access to proscribed information and the company is contemplating the use of an SSA to mitigate FOCI, the GCA shall provide DSS with a preliminary determination, 1 day prior to the due date assigned to the CFIUS filing by DTSA, as to whether a favorable NID will be provided. If the GCA does not notify DSS, DSS shall not delay implementation of a FOCI action plan pending completion of a GCA's NID process as long as there is no indication that the NID shall be denied.

(5) If DSS becomes aware of a proposed transaction that should be reviewed by CFIUS, and the parties thereto do not file a joint voluntary notice with CFIUS to initiate review within a reasonable time, DSS shall notify DTSA through the OUSD(I) Security Directorate.

(6) When a merger, sale, or acquisition is finalized prior to having an acceptable mitigation agreement in place, DSS shall invalidate the existing FCL until such time as DSS determines that the company has submitted an acceptable FOCI action plan in accordance with paragraph 2-303 of Reference (c).