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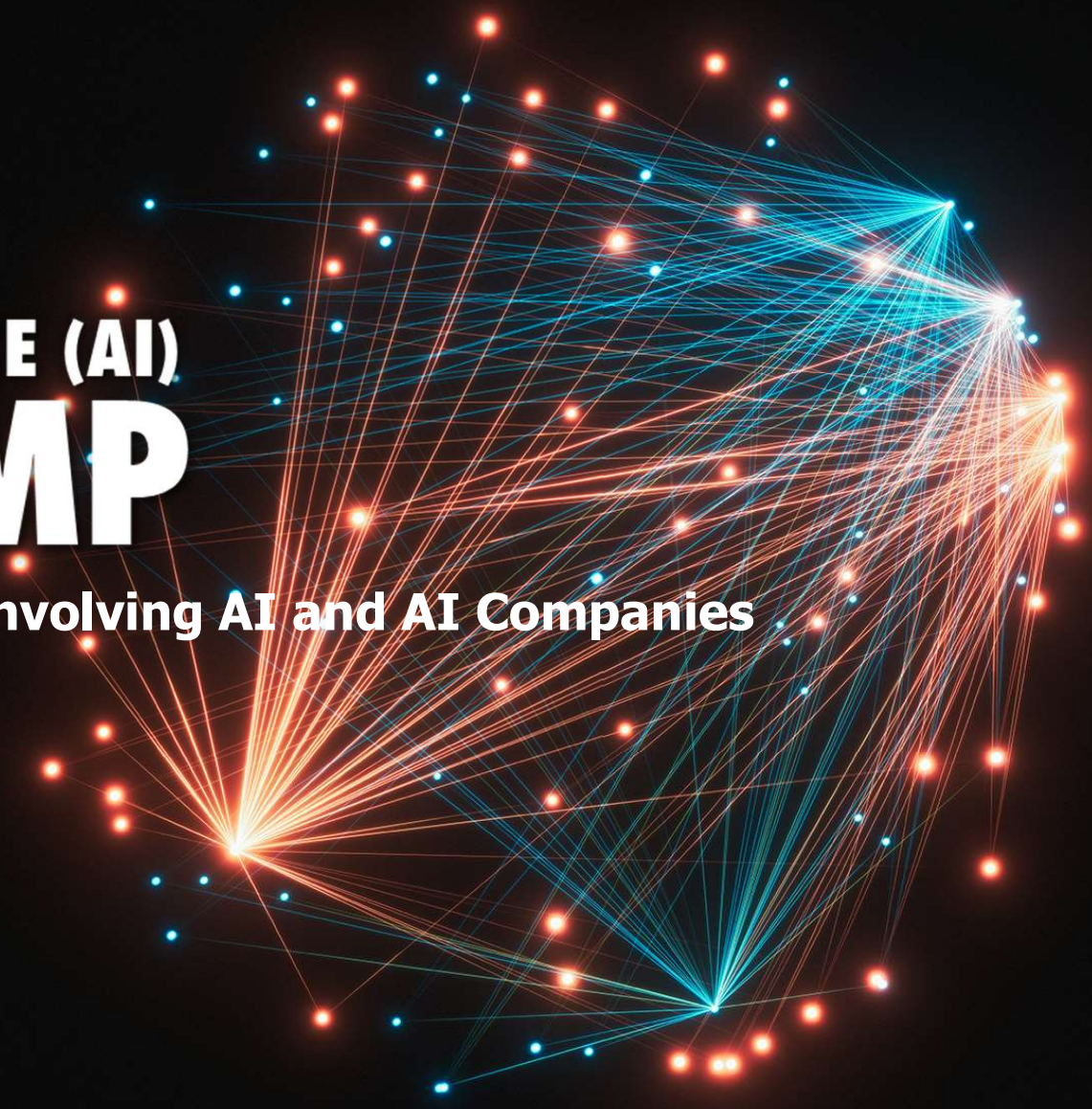
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**ARTIFICIAL INTELLIGENCE (AI)
BOOT CAMP**

CFIUS Focus on Transactions Involving AI and AI Companies

January 12, 2023

Kenneth J. Nunnenkamp



Host



Andrwe J. Gray IV

Presenter



Kenneth J. Nunnenkamp

Morgan Lewis



THE COMMITTEE ON FOREIGN INVESTMENT IN THE UNITED STATES (CFIUS)

- The US Government has been reviewing the impact of foreign direct investment (“FDI”) since at least 1975, through the Committee on Foreign Investment in the United States (“CFIUS”)
 - Initially the Committee was a Presidential tasking of agencies to provide the President feedback
- While the form changed from an advisory committee to an empowered one, reviews remain designed to assess and address national security concerns arising from foreign investments in the US
- CFIUS reviews “covered transactions” to assess whether they will or may impact US national security interests
- Over the course of several years, the US’s views regarding national security concerns adjusted to accommodate changed geopolitical factors, shifts in economic trends, and adjustments for critical, emerging, and disruptive technologies

CFIUS STATUTORY BACKGROUND

- Congressional acts since 1975 addressing FDI national security reviews
 - Exon-Florio Amendment to the Defense Production Act of 1950 (1988)
 - Byrd Amendment (1993)
 - Foreign Investment and National Security Act of 2007 (“FINSA”)
 - Foreign Investment Risk Review Modernization Act of 2018 (“FIRRMA”)
- CFIUS, which is administered by the US Treasury Department, issues regulations implementing the statutory requirements
 - 31 CFR Part 800 addresses general CFIUS jurisdiction
 - 31 CFR Part 802 addresses real estate transactions subject to CFIUS review
- CFIUS provides a limited amount of informal guidance
 - Most recently, CFIUS issued Enforcement Guidelines (very sparse)

FOREIGN INVESTMENT RISK REVIEW MODERNIZATION ACT OF 2018 (FIRRMA)

Relevant items changed by FIRRMA:

Mandatory filings for certain transactions

- Critical technologies
- Sensitive personal data
- Critical infrastructure

The scope of “covered transactions” (§ 1703(a)(4))

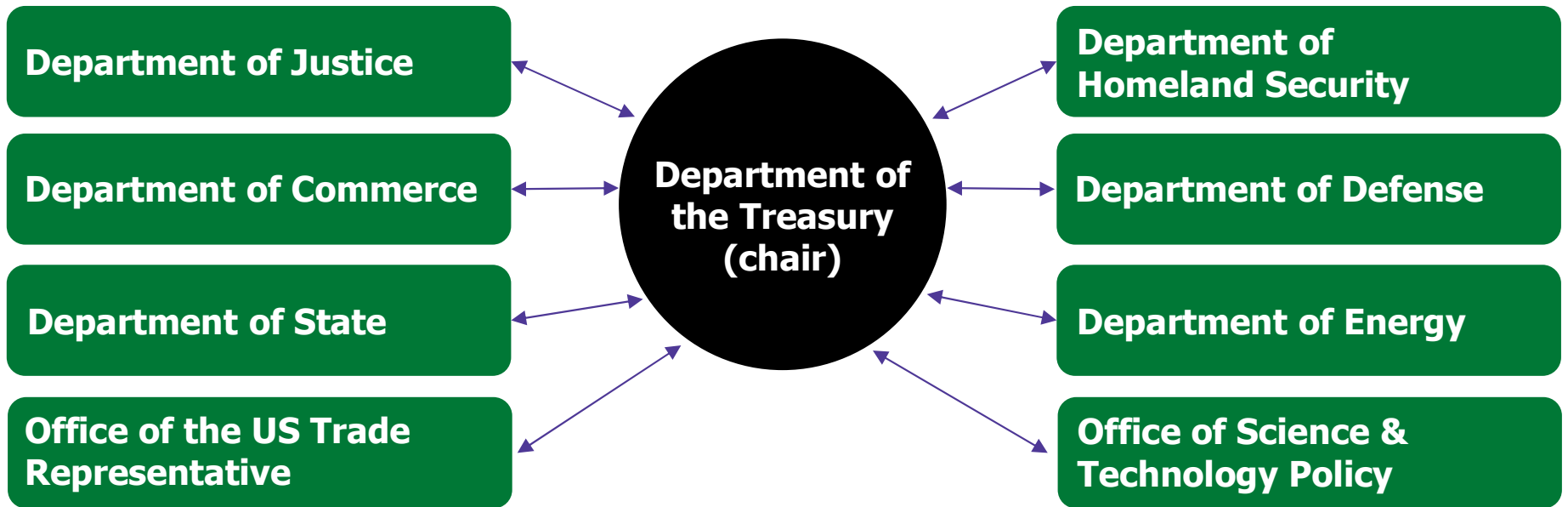
- Carving out and refined definition of passive investments
- Funds treatment

Time periods for reviews

Filing fees (§ 1723(p)(3)(B)) for certain voluntary filings

Real estate transactions

CFIUS MEMBERSHIP



CFIUS MEMBERSHIP

Any agency or function within the US Government may be called upon to provide assistance



CFIUS LEAD AGENCIES

- Lead Agency or Agencies
 - Determined by transaction based on Government agency interest or equities
 - Negotiate(s) and enter(s) into or imposes mitigation agreements
 - Retain(s) responsibility to monitor and enforce mitigation agreements
 - FIRRTA also enhances the role of lead agencies through the following
 - Can request an extra 15-day period for investigation
 - Can request ODNI updates
 - Can act on Committee's behalf with respect to conditions for withdrawal
- Mitigation is designed to address threats to national security posed by the transaction

CFIUS TIMELINES

- Joint Voluntary Notice (“JVN”)
 - Forty-five (45) calendar days for review (from date of acceptance of notice)
 - Additional 45 days for Investigation if needed
 - Further 15 days in “extraordinary circumstances”
- Declarations
 - Thirty calendars days from acceptance
 - Can roll into JVN if required by CFIUS
 - Or at parties’ election if not required

CFIUS REQUIREMENTS – DECLARATIONS

– Mandatory Declarations

– Required for select transactions that involve a “TID US Business”

- Control transaction or covered investment involving TID US Business
 - Where the US Business produces, designs, tests, manufactures, fabricates, or develops one or more “critical technologies” **and**
 - Where USG authorization would be required for the export of the critical technology/item to the party involved (*i.e.*, the acquiror, the investor, or one of the investors)
- A transaction that results in the acquisition of a substantial interest in a TID US Business by a foreign person where the national or subnational government of a single foreign state has a “substantial interest”
- Failure to file when required may be subject to civil penalty up to amount of transaction

CFIUS REQUIREMENTS – DECLARATIONS

- Declarations — Pros and cons
 - Less required information
 - Thirty calendar day review period commencing from acceptance
 - No “draft” period — immediate filing
 - Can be rejected if not complete; clock will not run until complete
 - CFIUS *may*
 - Provide safe harbor determination, but not required (required for JVN)
 - Determine it is not a covered transaction
 - Require submission of JVN due to need for more time/national security concerns
 - Make no decision
 - No filing fee
 - Avoid fine if mandatory

FIRRMMA

Key concepts and definitions

Covered transactions

Control or ownership

US Business

TID US Business

KEY DEFINITIONS/CONCEPTS

Covered transactions

- Covered control transactions
- Covered investment
- Change in rights that results in either of the above
- Any transaction “designed or intended” to circumvent CFIUS review

TID US Business

- Critical infrastructure
- Critical technologies
- US citizen sensitive personal information/“big data”

KEY DEFINITIONS/CONCEPTS

Covered control transactions

- Transaction results in control of US Business by foreign person

Control

- The power, direct or indirect, to act in concert, or to determine, direct, or decide important matters affecting the US Business
 - Power, whether or not exercised
 - Examples of such power:
 - The ownership of a majority or a dominant minority of the total outstanding voting interest
 - Board representation
 - Special share
 - Contractual arrangements
 - Formal or informal arrangements
 - Examples of important matters provided, but not exclusive

KEY DEFINITIONS/CONCEPTS

- Covered control transactions
 - Examples of important matters provided, but not exclusive
 - (1) The sale, lease, mortgage, pledge, or other transfer of any of the tangible or intangible principal assets of the entity, whether or not in the ordinary course of business;
 - (2) The reorganization, merger, or dissolution of the entity;
 - (3) The closing, relocation, or substantial alteration of the production, operational, or research and development facilities of the entity;
 - (4) Major expenditures or investments, issuances of equity or debt, or dividend payments by the entity, or approval of the operating budget of the entity;
 - (5) The selection of new business lines or ventures that the entity will pursue;
 - (6) The entry into, termination, or non-fulfillment by the entity of significant contracts;
 - (7) The policies or procedures of the entity governing the treatment of non-public technical, financial, or other proprietary information of the entity;
 - (8) The appointment or dismissal of officers or senior managers or, in the case of a partnership, the general partner;
 - (9) The appointment or dismissal of employees with access to critical technology or other sensitive technology or classified US Government information; or
 - (10) The amendment of the Articles of Incorporation, constituent agreement, or other organizational documents of the entity with respect to the matters described in paragraphs (a)(1) through (9) of this section.

KEY DEFINITIONS/CONCEPTS

- Covered investment transactions
 - Direct or indirect investment *in TID US Business* that
 - Is not a covered control transaction
 - Provides the foreign investor one or more of the following
 - Access to any material non-public technical information in the possession of the TID US Business
 - Membership, observer rights, or the right to nominate an individual to a position on, the board of directors or equivalent governing body of the TID US Business; or
 - Any involvement, other than through voting of shares, in substantive decision making of the TID US Business regarding one or more of the following
 - (i) The use, development, acquisition, safekeeping, or release of *sensitive personal data* of US citizens maintained or collected by the TID US Business
 - (ii) The use, development, acquisition, or release of *critical technologies*; or
 - (iii) The management, operation, manufacture, or supply of covered investment *critical infrastructure*.
 - The section 211 test or section 211 rights

KEY DEFINITIONS/CONCEPTS

- Covered investment transactions
 - The transaction meets the requirements of section 211
 - “Irrespective of the percentage of voting interest acquired”
 - ***General myth that a small voting interest means no CFIUS jurisdiction***
 - Even if CFIUS reviewed a prior investment by the same foreign person in the same TID US Business
 - Where the new transaction involves the acquisition of section 211 rights as a result of the new investment
 - Rights assessment is cumulative — includes new and original
 - If the US Business’s technology was identified as critical technology after the previous investment

KEY DEFINITIONS/CONCEPTS

Covered investment transactions

Incremental transactions rule (section 305)

- Only exempts control transactions
- Parties must be identical
- Foreign person investing must have gained control (*i.e.*, not a different foreign person)

Example

- Series A investor gets 5% under a covered transaction, cleared by CFIUS
- Investor joins Series B for an additional 5%
- Whether Series B is a covered transaction determined by Series B rights
- If Series A not notified, then irrelevant if Series B includes new rights

KEY DEFINITIONS/CONCEPTS

- A transaction is ***not*** a covered investment transaction if
 - There is no TID US Business
 - It is a covered control transaction
 - It does not provide the foreign investor ***any section 211*** rights
 - Access to material nonpublic technical information of the TID US Business
 - Board membership
 - Board observer rights
 - The right to nominate an individual to a position on the board of directors or equivalent governing body of the TID US Business
 - Involvement, other than through voting of shares, in substantive decision making of the TID US Business *regarding one or more of the following*
 - (i) The use, development, acquisition, safekeeping, or release of *sensitive personal data* of US citizens maintained or collected by the TID US Business
 - (ii) The use, development, acquisition, or release of *critical technologies*, or
 - (iii) The management, operation, manufacture, or supply of covered investment *critical infrastructure*

KEY DEFINITIONS/CONCEPTS

- Additional investments that are not covered investment transactions
 - A stock split or pro rata stock dividend that does not afford the foreign person section 211 rights
 - An acquisition of securities by a person acting as a securities underwriter, in the ordinary course of business and in the process of underwriting
- Special rule for incremental acquisitions
 - When a transaction results in an acquisition or investment that provides an additional interest in, or that results in a change in rights of the foreign person (or any entity that it wholly owns directly or indirectly)
 - ***If the foreign investor***
 - Previously acquired direct control as a result of a covered control transaction
 - CFIUS reviewed and cleared the transaction
 - New transaction is not a covered transaction

KEY DEFINITIONS/CONCEPTS

Documentation to ensure that the transaction is not a covered investment transaction

- Provisions prohibiting foreign investors from obtaining any of the section 211 rights
- Side agreements acknowledging no section 211 rights

Rights may be contingent on events outside investor's control

- *i.e.*, MFN rights for future rounds
- Liquidation event

KEY DEFINITIONS/CONCEPTS

- US Business
 - Any entity “engaged in interstate commerce in the US”
 - Generally does not include company engaged only in sales to US persons or foreign subsidiaries of US companies
 - CFIUS examples, which are part of the regulations, make this clear
 - Foreign company, organized under the laws of a foreign state, wholly owned and controlled by foreign national, with no branch office, subsidiary or fixed place of business in the US
 - Company exports and licenses technology to an unrelated company in the US and provides remote technical support services to customers in the US
 - Company does not have any assets or personnel located in the US
 - ***Not a US Business***
 - Foreign company organized under the laws of a foreign state, wholly owned and controlled by US company that is wholly owned and controlled by US persons
 - The foreign subsidiary does not have a branch office, subsidiary, or fixed place of business in the US
 - The foreign subsidiary exports goods to the US
 - ***Not a US Business***

KEY DEFINITIONS/CONCEPTS

TID US Business

- Any US Business that
 - Produces, designs, tests, manufactures, fabricates, or develops one or more critical technologies
 - Performs specific functions described in Appendix A to the regulations with respect to covered investment critical infrastructure
 - Maintains or collects, directly or indirectly, sensitive personal data of US citizens
- Each key term is defined with some detail

TID Business analysis is a gate to mandatory declaration analysis

KEY DEFINITIONS/CONCEPTS

TID US Business – Critical technology

- ITAR-controlled defense articles or defense services
- EAR-controlled articles or technology that is controlled under one of the following
 - Pursuant to multilateral regimes for reasons relating to national security, chemical and biological, weapons proliferation, nuclear nonproliferation, or missile technology
 - For reasons relating to regional stability or surreptitious listening
- Items that are specially designed and prepared nuclear equipment, parts and components, materials, software, and technology covered by 10 CFR part 810 (relating to assistance to foreign atomic energy activities);
- Nuclear facilities, equipment, and material covered by 10 CFR part 110 (relating to export and import of nuclear equipment and material);
- Select agents and toxins covered by 7 CFR part 331, 9 CFR part 121, or 42 CFR part 73
- Emerging and foundational technologies controlled under section 1758 of the Export Control Reform Act of 2018 (50 U.S.C. 4817).

KEY DEFINITIONS/CONCEPTS

TID US Business – Critical technology

- Artificial Intelligence as a Critical Technology
 - AI has been on the CFIUS radar for a long time—well before FIRRMA
 - Multiple determinations of AI as a critical technology
 - Executive Order 14083 (Sept. 15, 2022)
 - Cites AI as a critical technology for
 - Supply chain
 - As “fundamental to United States technological leadership”
 - National Science and Technology Council (Feb 2022) Critical and Emerging Technologies List Update (and 2020)
 - Included AI on list of “critical and emerging technology areas are of particular importance to the national security of the United States
- NSTC Role is ensure that science and technology policy decisions and programs are consistent with the President’s stated goals

KEY DEFINITIONS/CONCEPTS

TID US Business – Critical technology

- Artificial Intelligence as a Critical Technology
- FIRREA early promulgation due in part to perception that CFIUS was not effectively blocking AI-related transactions
- Difficulty defining exactly what is “AI”
- Key areas
 - Drone technology
 - IoT
 - Early Stage Focus

CFIUS Tools Existing and Contemplated

TID US Business – Critical technology

- Artificial Intelligence as a Critical Technology
 - Non-notified reviews
 - CFIUS Resources
 - Non-Notified Process, Results
- Outbound regime proposals
 - Whether CFIUS or another
 - Support/Opposition
- CFIUS Innovation/Reform on the way?
 - Commission on Foreign Investment and National Security (CFINS)

KEY DEFINITIONS/CONCEPTS

TID US Business – Critical technology

- Artificial Intelligence as a Critical Technology
- Includes:
 - Artificial Intelligence (AI)
 - Machine learning
 - Deep learning
 - Reinforcement learning
 - Sensory perception and recognition
 - Next-generation AI
 - Planning, reasoning, and decision making
 - Safe and/or secure AI
 - Specialized/tailored hardware components for artificial intelligence, under Semiconductors and Microelectronics

KEY DEFINITIONS/CONCEPTS

TID US Business – Sensitive personal data

- Collection or retention of specifically identified types of data that meet the following additional criteria
 - US citizens' data
 - Already collect data of more than 1 million US persons or has the capability to do so
 - Data is an integrated part of the US Business's primary products or services
- Excludes data that is
 - Of public record
 - Employee data

KEY DEFINITIONS/CONCEPTS

TID US Business – Critical infrastructure

- Systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems or assets would have a debilitating impact on national security
- Analysis requires that the infrastructure fall within column A and perform the functions enumerated in column B of Appendix A

Example:

Column A

(a) Internet protocol network that has access to every other internet protocol network solely via settlement-free peering; or

Column B

(a) Internet protocol network that has access to every other internet protocol network solely via settlement-free peering; or

This is not a mistake

SPECIAL RULES FOR CONTINGENT EQUITY INTERESTS

CFIUS applies special rules to contingent equity interests

CFIUS jurisdiction exists over contingent interests

CFIUS looks at several factors when deciding whether to exercise jurisdiction over contingent interests, including

- The imminence of conversion or satisfaction of contingent conditions
- Whether conversion or satisfaction of the contingent conditions depends on factors within the control of the acquiring party
- Whether the amount of interest and the rights that would be acquired upon conversion or satisfaction of the contingent conditions can be reasonably determined at the time of the acquisition of the contingent interest

CFIUS AUTHORITY TO ACT

CFIUS actions following a review and/or investigation

Clear the transaction – “no unresolved national security issues”

Recommend the President block the transaction

Require mitigation

- Mitigation can include any actions necessary to address the national security concerns
- Examples of the types of mitigation CFIUS imposes
 - Physical security limitations
 - Limitations on access to technology
 - Limitations on access to personal data

CFIUS ANALYSIS

Progression Analysis

Is the transaction subject to a mandatory filing (declaration)?

- If yes, should the parties submit a declaration or JVN?
 - Increased likelihood that declaration will lead to JVN because of TID US Business
 - Effectively extends timeframe
 - Increased likelihood for mitigation or other CFIUS action

If it is not subject to a mandatory filing requirement

- Should the parties submit a voluntary notice or declaration
- Will CFIUS inquire during transaction process, thereby disrupting process
- Will a post-closing inquiry create concerns (“non-notified transaction reviews”)

Coronavirus COVID-19 Resources

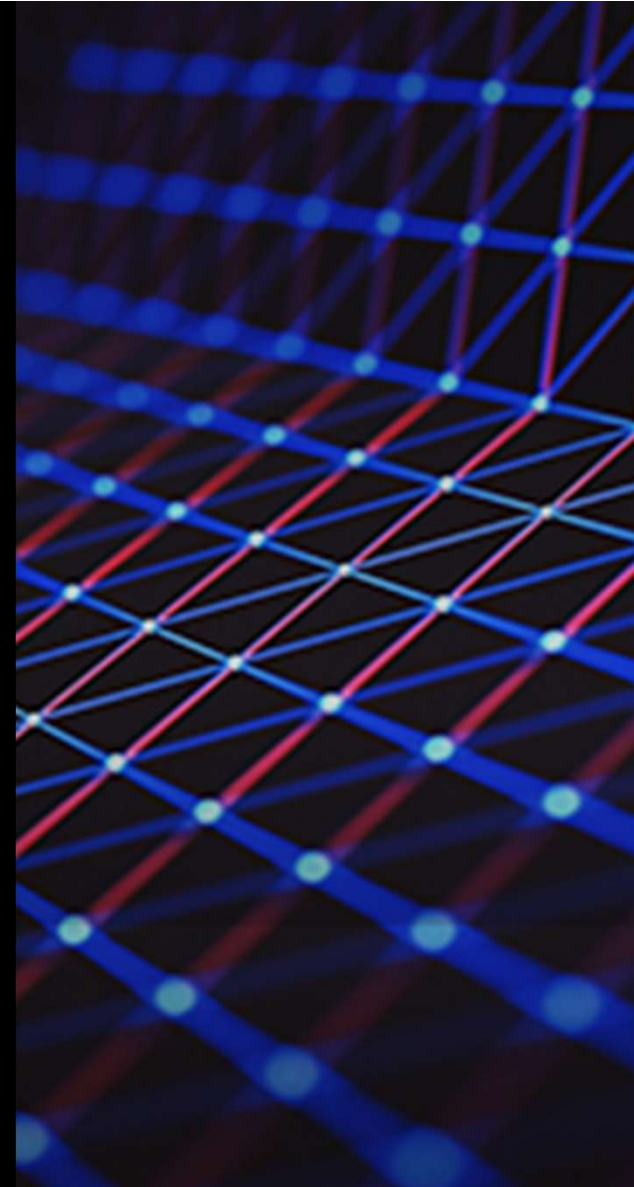
We have formed a multidisciplinary **Coronavirus/COVID-19 Task Force** to help guide clients through the broad scope of legal issues brought on by this public health challenge.

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To help keep you on top of developments as they unfold, we also have launched a resource page on our website at

[www.morganlewis.com/
topics/coronavirus-
covid-19](http://www.morganlewis.com/topics/coronavirus-covid-19)

If you would like to receive a daily digest of all new updates to the page, please visit the resource page to [subscribe](#) using the purple "Stay Up to Date" button.



Biography



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Ken Nunnenkamp represents clients in international trade and national security matters before United States federal courts and government agencies, including the US departments of State, Commerce, Homeland Security, Defense, and Treasury. His practice involves internal investigations and disclosures, including voluntary disclosures and responding to government demands, as well as federal court defense against government actions. He also advises on compliance counseling and training, transactional due diligence—including both domestic and cross-border transactions—and statutory submissions to US government agencies.

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Serving as the leader of the firm's semiconductor practice and as a member of the firm's fintech and technology industry teams, Andrew J. Gray IV concentrates his practice on intellectual property litigation and prosecution and on strategic IP counseling. Andrew advises both established companies and startups on AI, machine learning, Blockchain, cryptocurrency, computer, and Internet law issues, financing and transactional matters that involve technology firms, and the sale and licensing of technology. He represents clients in patent, trademark, copyright, and trade secret cases before state and federal trial and appellate courts throughout the United States, before the US Patent and Trademark Office's Patent Trial and Appeal Board, and before the US International Trade Commission.

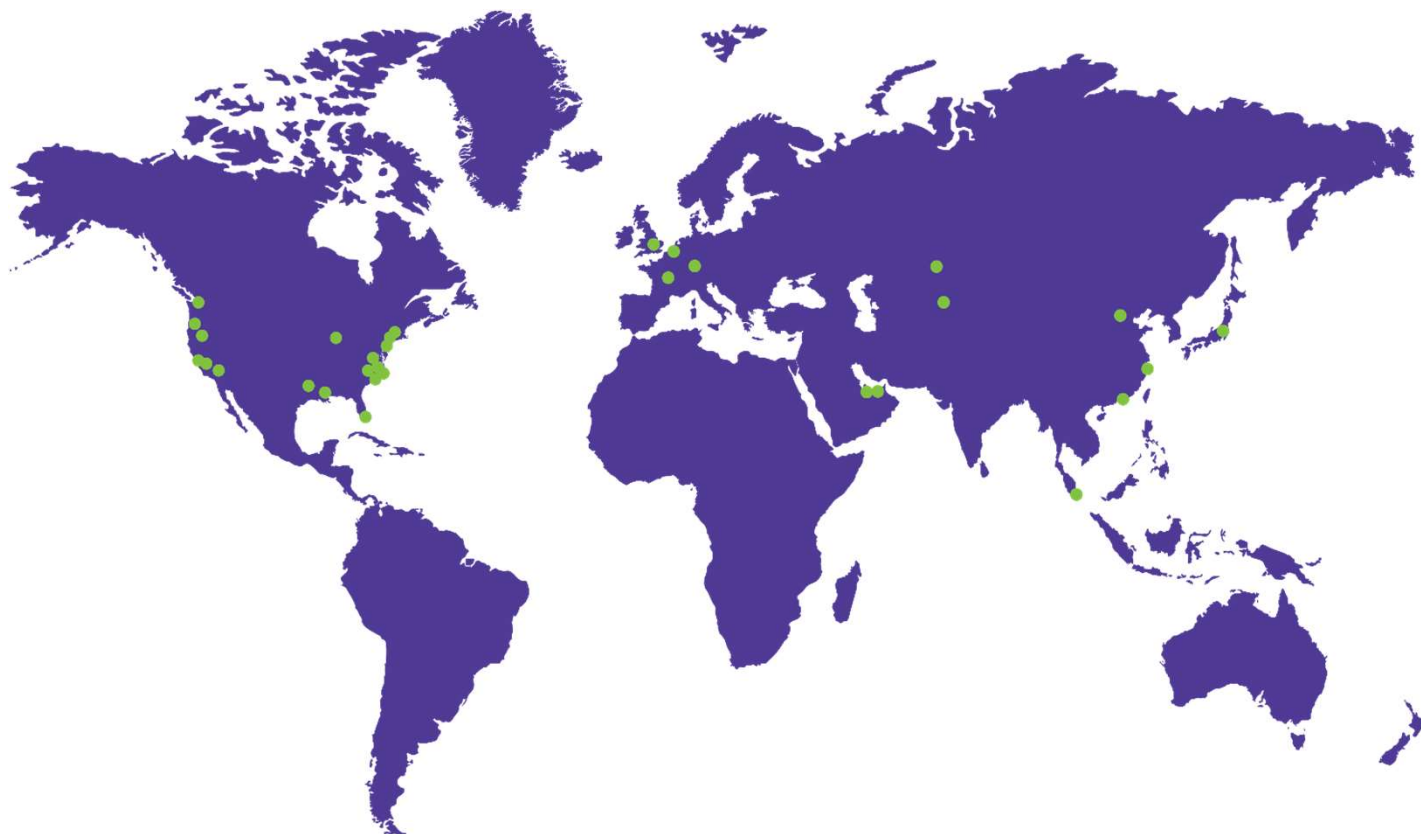
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Our Global Reach

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