

NVCA Includes Detailed CFIUS Terms in its Model VC Term Sheet

by Catherine X. Pan-Giordano and Ting Zhou

Question 1: What is NVCA and its Model Legal Documents?

The National Venture Capital Association (“NVCA”) is the premier trade association that represents the U.S. venture capital industry. It is widely recognized as a trusted source for venture capital industry positions and data.

NVCA publishes model legal documents for venture capital financings, which reflect current practices and customs, and are widely accepted in the venture capital industry as a starting point for deal parties to develop legal documents for each transaction. The model venture capital term sheet (“VC Term Sheet”) lays out the basic terms and conditions in major aspects of an investment, on which the definitive legal documents are developed.

Question 2: Why did NVCA include CFIUS related terms in the model VC Term Sheet?

Foreign Investment Risk Review Modernization Act of 2018 (“FIRRMA”) was passed in August 2018. FIRRMA amends significantly Section 721 of the Defense Production Act of 1950 (“Section 721”), which authorizes the President of the United States to investigate, suspend or prohibit any transaction resulting in control of a U.S. business by a foreign person where the President determines such transaction threatens to impair U.S. national security and no other adequate means are available to address the identified threat. Since 1988, Section 721 has governed the work of the Committee on Foreign Investments in the United States (“CFIUS”), a federal interagency committee. The significant changes after FIRRMA include the expanded jurisdiction and scope of CFIUS, introduction of new “declaration” process and extended period of the CFIUS review process. For more information about CFIUS reform and FIRRMA, please see [“CFIUS Announces Pilot Program: Mandatory Declaration Filings in Connection with Certain Transactions”](#) posted on October 23, 2018. In response to the new legislation of FIRRMA, NVCA updated its model VC Term Sheet to include several provisions

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regarding CFIUS review (as further discussed below).

Questions 3: What are the new CFIUS related terms included in NVCA's VC Term Sheet?

1. **Representations and Warranties.** Representations and warranties regarding CFIUS review are advised to be considered to address issues under Section 721, FIRRMA and related regulations. For example, the investor may request the target company to represent that it does not work with "critical technologies" nor does it have any operations or activities in particular sectors of the United States economy or in the United States. On the other hand, the target company may request an investor to make representations regarding the investor's nationality and its relationship with any foreign government.
2. **Regulatory Covenants.** If a CFIUS filing is necessary or advisable based on the facts of the specific transaction, covenants may be included that investors and the target company should use reasonable best efforts to submit the proposed transaction to CFIUS and obtain CFIUS clearance. In addition, the parties may also elect to negotiate a basic statement laying out the scope of the investor's obligation to accept conditions imposed by CFIUS. For example, an investor may want to stipulate that it has no obligation to take or accept any action, condition, or restriction as a condition of CFIUS clearance that would have a material adverse impact on the target company or the investor's right to exercise control over the target company.
3. **Conditions to Closing.** If the investor reviews the facts of the investment and determines that a CFIUS filing is necessary or advisable, it may wish to include the CFIUS clearance as a condition to close the transaction. Please note that in case where a mandatory filing is necessary, mandatory declarations must be submitted at least 45 days before the expected completion date of the transaction, but obtaining CFIUS clearance in advance of closing is not a requirement of law. However, submitting a CFIUS filing and then closing over that review process creates regulatory risks for an investor that are best avoided if the timing of the investment permits.
4. **Limitations on Pre-CFIUS-Approval Exercise of Rights.** If a transaction is intended to be partially closed before the CFIUS clearance is received, the parties may consider including a restrictive provision on the investor's rights that might create grounds for CFIUS jurisdiction until the CFIUS clearance is obtained. For example, the investor may be restricted from obtaining control over the target company, access to certain material nonpublic technical information, membership or observer rights on the board or right to nominate a board member, or participation in substantive decision-making of the target company.
5. **Springing CFIUS Covenant.** If the investor believes that there is risk that CFIUS may request a filing of the transaction in the future or that a CFIUS filing may be required in the event of some future events (e.g., when the exit of another investor causes certain investor to obtain control over the selection of a board member), it may want to consider including a springing CFIUS covenant to the effect that, in the event of such future event, investors and the target company should use reasonable best efforts to submit the proposed transaction to CFIUS and obtain CFIUS clearance. A springing CFIUS covenant provides certainty that all parties will proceed at CFIUS in orderly fashion.

Question 4: What are the takeaways for Chinese investors?

Including the CFIUS related terms in the model VC Term Sheet indicates a current practice in the U.S. venture capital industry – CFIUS issues are expected to be

considered for venture capital investments. Given that China is likely one of the countries of special concern for CFIUS review, for any venture capital investment in a U.S. business that a Chinese investor intends to make, the investor should consider the CFIUS issues and seek legal advice as early as possible.

Although most CFIUS filings are voluntary, expect for some mandatory filings required by FIRRMA, CFIUS retains jurisdiction indefinitely to request a filing and review a transaction even after the transaction closes. Some investors may have the impression that CFIUS focuses its attention on big deals. The focus has been expanded recently, and forcing smaller companies into a divestment seems to be new CFIUS trend. On April 4, 2019, PatientsLikeMe, a patient social network startup, was reported to be forced to find a buyer after the U.S. government has ordered its majority owner, the Chinese investor iCarbonX, to divest its stake. According to media reports, iCarbon X's investment in PatientsLikeMe was not presented to CFIUS for clearance before closing, because at the time of the deal in 2017, CFIUS had not shown any interest in transactions of that size or in the health industry. In addition, a few weeks ago, Beijing Kunlun Tech Co Ltd., a Chinese gaming company, was reported to be facing pressure from CFIUS to relinquish control of the gay dating app Grindr because of certain concerns that China would use information about American officials' sexual orientation or dating habits to blackmail or influence them. Given the new trend that CFIUS seems to become more systematic at looking into transactions and to have broadened its areas of concerns, Chinese investors may take a more conservative approach in deciding whether to submit a voluntary CFIUS filing to avoid the risks of future divestiture.