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Lessons as a Chinese firm looks to divest CFIUS-approved acquisition

The digital payments arm of Chinese ecommerce giant Alibaba plans to sell off a Kansas City-based biometric security firm it acquired with the blessing of CFIUS in 2016. Here are all the basics you need to know, with expert insights at the bottom:

THE BACKSTORY

In September 2016, Ant Financial, the ecommerce arm of Alibaba, announced it would acquire EyeVerify for approximately $100 million.

EyeVerify, based in Kansas City, eliminates the need for passwords through its facial recognition technology. Originally known as "EyePrint ID," which verified identities through unique patterns in human eye veins, the company's newest products include "smile to pay" transaction systems and other facial-recognition technologies.

The company was founded by Toby Rush, who served as CEO until the Ant Group acquisition; he remained with Ant as Senior Director of International Technology Investments for nearly three years, before joining another Kansas City startup as CEO.

EyeVerify was rebranded as ZOLOZ after the acquisition.

THE CFIUS LINK

The 2016 purchase was approved by the Committee on Foreign Investment in the U.S.

Interestingly, the disclosure of CFIUS clearance was embedded in another SEC filing that looked to defend against "baseless allegations" that Ant was controlled by the Chinese government.

That disclosure noted that "Ant Financial successfully completed a review by CFIUS last year when it purchased Kansas City-based EyeVerify."

The disclosure was reported in our downloadable CFIUS disclosure tracking spreadsheet.

THE DIVESTITURE

Despite the CFIUS clearance, executives at Ant Group (which was previously called Ant Financial) told the Financial Times that it was planning to sell EyeVerify "amid growing tensions between Beijing and Washington over China's technology companies and tightening scrutiny over U.S. data."

This was despite the fact that deal had already been okayed by CFIUS, and that the company "had not collected data" from EyeVerify about U.S. users. In fact, an unnamed executive told the FT that user data "did not leave the smartphones that performed the scans."

According to the ZOLOZ Website, the company "continues to be fully managed and operated by US personnel located in Kansas City, Missouri."

CONTEXT

There have, of course, been several instances of CFIUS forcing a divestiture of U.S. entities by Chinese companies.

As Foreign Investment Watch has covered in the past, for example, CFIUS required that Beijing Kunlun Tech sell is ownership of dating app Grindr, and forced Chinese genome company iCarbonX to divest its majority ownership of PatientsLikeMe.

However, the recent move by Ant Group does not appear to be driven by CFIUS; in fact, CFIUS approved the deal four years ago. Rather, the move appears driven by commercialization challenges amid scrutiny of Chinese-owned companies. And new Commerce Department rules may be playing a role here, as well (see "Lessons," below).

THE LESSONS

The divestiture of the company by Ant comes as scrutiny of Chinese companies has increased. Not only have Chinese companies been delisted or banned from U.S. transactions, but new rules enable the Commerce Department to prohibit certain transactions from "malicious foreign adversaries," including China.

According to Olga Torres, founder of the eponymous firm Torres Law, the move to sell EyeVerify may be a harbinger for additional divestitures. At a minimum, increased scrutiny of Chinese-owned technologies in the U.S. could force those companies to reassess their strategies. "[T]his case could add steam to Chinese-owned U.S. companies to at least begin assessing risks and options," she adds.

Experts actually believe this scrutiny could lead to more M&A, particularly as financial players look to make preemptive and opportunistic acquisitions. "We have even heard of rumors that U.S. companies with Chinese owners are being targeted by private equity groups [and] investors trying to buy them preemptively, potentially at a discount, before the U.S. government reviews them again," says Torres.

In addition to CFIUS and market pressures, it's possible that new Commerce Department rules, which enable Commerce to review and ban certain transactions touching the "Information and Communications Technology and Services Supply Chain," may be weighing on the Chinese owner.

"I would not be surprised if the new Commerce interim final rules start to weigh on companies like [Ant parent company] Alibaba," one legal expert told Foreign Investment Watch. "It's just another pressure point that complicates rapid growth and sales," she adds.

To be clear, the Commerce "ICTS" rule may not have jurisdiction here, for several reasons. In addition to the fact that EyeVerify may not be an ICTS technology, Torres notes that Commerce's interim final rule "excludes transactions that CFIUS has reviewed, though the exclusion does not extend to subsequent ICTS transactions if distinct from the previously-reviewed CFIUS transaction, or if new information is discovered."

However, the Commerce rule does adds complexity and risk to Chinese-owned companies seeking broader U.S. market adoption. "The new rule would certainly just add more uncertainty and further incentivize companies to review risks and assess potential options, including potentially considering proactive divestment [or] divestitures," says Torres.

MORE INFORMATION

EyeVerify is now known as Zoloz.

The SEC filing that discloses CFIUS clearance of the acquisition by Ant is available.

The Financial Times article that broke the story is online, although a paid subscription may be required to access it.

The Commerce interim final rule, referenced in the article above, was covered in a recent edition of Foreign Investment Watch.

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