

10 Takeaways From the CFIUS Annual Report to Congress

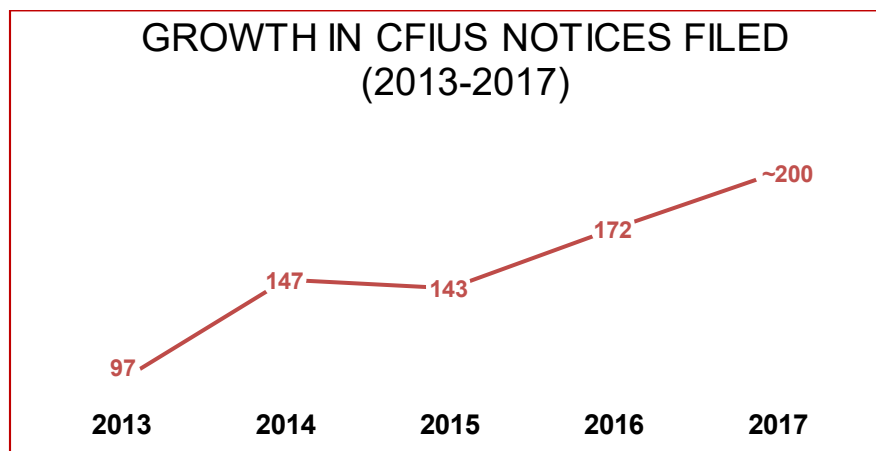
Calendar Year 2015 CFIUS Report reflects review of transactions for national security risks is generally taking longer, with Chinese investors leading all others.

The [Committee on Foreign Investment in the United States](#) (CFIUS) recently released the public version of its [Annual Report to Congress for CY 2015](#) (Report), which provides an overview of the notices submitted to CFIUS in calendar year 2015 in connection with foreign investment in US businesses. Among other information, the Report includes aggregated statistical data with respect to the transactions submitted to CFIUS for review in that calendar year. Because CFIUS publishes these required annual reports more than a full year after the covered period, the current Report does not fully reflect more recent trends, including increases in the level of CFIUS aggressiveness towards certain types of foreign investors and the overall increase in CFIUS filings in 2016 and 2017.

This *Client Alert* summarizes some of the key takeaways from the Report:

1. The Report confirms that the number of voluntary notices filed with CFIUS has increased in the past few years, with significant increases in 2016 and expected in 2017.

The Report shows that CFIUS reviewed 143 notices in 2015, which is roughly the same as the 147 notices reviewed in 2014. Both of these counts represent a significant (~50%) increase over the 97 notices filed in 2013. CFIUS has separately reported that it reviewed 172 notices in 2016 — a meaningful (~20%) increase from 2015. We expect this trend to be continue, with CFIUS likely exceeding 200 cases in 2017. This trend is illustrated in the following graph:



2. The Report reflects that Chinese investment continues to generate the largest number of transactions reviewed by CFIUS.

In 2015, Chinese investors once again submitted more CFIUS notices than investors from any other country. In 2015, of the 143 notices submitted to CFIUS, 29 related to Chinese investors. For context, the second-leading investor country in 2015 was Canada, with 22 notices submitted to CFIUS. Other top countries were the United Kingdom (19 notices in 2015), Japan (12 notices in 2015), and France (8 notices in 2015). In comparison to filings made in 2014, the countries and territories that experienced the largest decrease in CFIUS submissions in 2015 were Germany, Hong Kong, and South Korea. Based on press reports and other information, Chinese investors appear to have been the most significant source of CFIUS filings in 2016, which seems likely to hold true in 2017, possibly with an even more significant increase in the percentage of the CFIUS caseload.

Calendar Year	Number of Total CFIUS Filings	Number of China-Related Filings	Percentage of CFIUS Caseload
2013	97	21	21%
2014	147	24	16%
2015	143	29	20%

3. The Report confirms that CFIUS has been increasingly more likely to extend initial 30-day “reviews” into longer “investigations.”

After CFIUS accepts a joint notice submitted by the parties to a transaction, the Committee will initiate a 30-calendar-day “review” of the transaction. If, at the end of that 30-day review period, the US agencies that make up the Committee can conclude that the transaction will not pose an unacceptable risk to US national security interests, CFIUS will clear the transaction. If CFIUS cannot make such a determination at that time, the case will be rolled into an “investigation” period, which can last up to an additional 45 calendar days. (For a more detailed description, please review Latham’s [Overview of the CFIUS Process](#) and [Key Questions Answered on CFIUS](#).)

The Report reflects that CFIUS extended the initial review period in connection with 66 of the 143 notices filed in 2015 (an investigation rate of 46%). CFIUS has separately released data indicating a similar investigation rate in 2016, and the authors believe the percentage of cases that reach investigation continues to increase. These trends reflect some combination of: (i) CFIUS’ increased scrutiny of the transactions that come before it; (ii) transactions submitted to CFIUS are more challenging; and (iii) resource constraints, which in at least some cases have precluded CFIUS from being able to clear a transaction during the review period — even if no specific national security concern has been identified.

4. The Report reflects that parties withdrew filings at a rate similar to previous years, but refiled a much higher percentage of those notices.

Under the statutory framework governing the CFIUS process, CFIUS must normally conclude its evaluation of a transaction within 75 calendar days after officially accepting a CFIUS notice. In recent years, CFIUS has used of various procedural tools to effectively extend this period. Among other actions, CFIUS may encourage the parties to withdraw and refile their notices, essentially restarting the “clock” for the CFIUS process to allow for a longer total review period.

In 2015, parties withdrew 13 of the 143 notices filed prior to the completion of the CFIUS process (9% of the total). This is similar to the 12 notices withdrawn in 2014 (8% of the total). However, whereas parties refiled only one of the 12 notices withdrawn in 2014, parties refiled nine of the 13 notices withdrawn in 2015. These numbers likely reflect increased use of a “pull-and-refile” procedure. The authors believe this trend has continued in 2016 and 2017.

5. The delayed release of the Report likely reflects the increased resource constraints under which CFIUS has been operating.

CFIUS typically publishes its annual report to Congress with respect to a given calendar year either at the end of the following year or the beginning of the one after that. But CFIUS released the Report with respect to CY2015 in September 2017— several months after the expected publication date, and more than eighteen months after the last annual report was released. This likely reflects a number of factors, including the Committee’s current caseload, which has grown significantly over the past few years (see below), general resource constraints, and more challenging cases. In addition, following the transition to the Trump Administration, several key leadership positions with connections to the CFIUS process remain unfilled, which may have impacted the timing of the Report.

6. The Report indicates that CFIUS rejected one filed notice in 2015 based on the parties’ failure to provide information consistent with other information available to CFIUS.

In 2015, CFIUS rejected a filing because information provided by the parties contradicted other information available to the US government, and in that case the parties abandoned the transaction. This rejection demonstrates the care that CFIUS takes in reviewing information provided by the parties, as well as the US government’s access to extensive information *not* provided by the parties themselves (including, in many cases, classified and other non-public information).

7. The Report suggests that certain foreign governments are engaging in coordinated strategies and espionage aimed at obtaining “critical technologies” from US companies.

CFIUS is required annually to assess whether there is credible evidence of: (i) a coordinated strategy by one or more countries to acquire US companies involved in research, development, or production of “critical technologies” or (ii) industrial espionage activities assisted by foreign governments against US companies aimed at obtaining commercial secrets related to such critical technologies. The Report concludes that there is a high likelihood of espionage activity but, given the Report’s unclassified nature, declines to provide an assessment of whether a “coordinated strategy” exists.

8. 2015 saw a sustained increase in the number of voluntary notices involving US businesses in the manufacturing category, and in particular in the semiconductor industry.

68 of the CFIUS notices filed in 2015 (48% of the total) involved businesses in the manufacturing category, similar to 2014 numbers and reflecting a sustained increase from 2013, in which only 35 notices (36% of total) involved US businesses in the manufacturing category. Notably, the Report shows CFIUS reviewed 12 transactions in the semiconductor space in 2014, as compared to 18 in 2015. The authors expect that transactions filed in 2016 and 2017 will also support this trend. Moreover, of the four transactions blocked or unwound by the President of the United States between 1990 and 2017, two have been in the semiconductor space, and all four transactions have involved investors from China. In [September 2017](#), President Trump blocked the acquisition of Lattice Semiconductor Corporation by Canyon Bridge Capital Partners. In [December 2016](#), President Obama blocked a Chinese consortium’s acquisition of the US business of German company Aixtron SE. Certain transactions in the semiconductor space have also been blocked by CFIUS – meaning the parties voluntarily abandon a transaction after being advised that CFIUS will recommend that the President block the transaction. Those cases have even involved foreign investors from ally countries. And while the four cases either blocked or unwound by the President have involved investors from China, the data released by CFIUS show that most China cases are being approved, albeit with mitigation in many instances.

9. The Report reflects CFIUS' continued use of mitigation techniques to address perceived national security risks, as well as new mitigation measures.

From 2013 through 2015, 40 cases (10% of the total) resulted in the parties agreeing to mitigation proposed by CFIUS. In such cases, as a condition of granting CFIUS clearance, CFIUS sought to address perceived national security risks arising from certain transactions by negotiating mitigation arrangements with the parties. In 2015, CFIUS took this approach in connection with 11 notices (about 7.5% of the total). This figure represents a slight increase in the "mitigation rate" from 2014, when nine notices (6% of the total) resulted in negotiated mitigation arrangements. In 2013, in contrast, CFIUS struck mitigation agreements in 11 cases (11% of the total). Common mitigation measures include:

- Ensuring that only authorized personnel have access to certain sensitive technology and information, including US government customer information, and restricting the foreign acquirer's direct or remote access to systems with such information
- Establishing guidelines and terms for handling existing or future US government contracts, US government customer information, and other sensitive information
- Ensuring that certain key functions are performed only by US citizens or within US borders
- Notifying security officers or relevant US government parties in advance of foreign national visits to the US business for approval

Notably, in the Report, CFIUS identified four new mitigation measures not included in previous reports:

- Implementing security protocols to ensure the integrity of goods and software sold to the US government
- Requiring that customers of the US business be notified of the change of ownership
- Securing assurances of continuous supply of products or services for defined periods, and notification and consultation prior to taking certain business decisions, with certain rights if the US business decides to exit a business line. This would include requiring meetings with the US government to discuss business plans that might affect US government supply or implicate other national security considerations
- Excluding certain sensitive assets from the transaction

10. The Report identifies factors that could give rise to potential national security threats, including new factors.

The Report for the first time identified as a relevant concern US businesses that "hold substantial pools of potentially sensitive data about US persons and business" in sectors of national security importance. The Report highlights, in particular, such data in the insurance, health services, and technology services sectors. Such data could include social security numbers, personal addresses, credit card information, and the like. For the first time, CFIUS also identified as a factor those US businesses "in a field with significant national security implications in which there are few alternative suppliers or in which a loss in U.S. technological competitiveness would be detrimental to national security." These new factors are consistent with a larger trend of CFIUS increasingly looking beyond what would ordinarily be perceived as critical infrastructure. For instance, in 2013 CFIUS reviewed the proposed acquisition of US pork producer Smithfield Foods by Shuanghui International Holdings, a Chinese investor. While CFIUS cleared the transaction, media reports suggest the review extended until the end of the 45-day investigation period.

Among other recommendations, the Report suggests that CFIUS continue to focus on a few areas of concern, including foreign “control” of US businesses to which any of the below apply:

- Provide products and services to US government agencies with national security functions
- Provide products or services that could expose national security vulnerabilities, including cyber security and supply chain concerns
- Have operations, produce goods, or provide services, the nature of which may implicate US national security (including, in particular, businesses that involve critical infrastructure, involve aspects of energy production, affect the national transportation system, or significantly and directly affect the US financial system)
- Have access to classified or other sensitive US government information or contracts, including information about US government employees
- Are part of the US defense, security, or law enforcement sectors
- Are involved in activities related to weapons, munitions, aerospace, and radar systems
- Produce advanced technologies useful to national security (including semiconductors, biotechnology, network and data security products, and other “dual-use” products)
- Engage in research and development, production, or sale of technology, goods, software, or services subject to US export controls
- Are in geographic proximity to US military facilities or other sensitive US government facilities
- May be acquired by foreign persons that are controlled by a foreign government
- May be acquired by foreign persons that are from a country about which there are nonproliferation or other national security-related concerns
- May be acquired by foreign persons that have a history of taking or intending to take actions that could impair national security
- May be acquired by foreign persons with a history or doing business in US-sanctioned countries (such as Iran, Syria, and North Korea).

Conclusion

There are efforts in Congress to extend CFIUS’ reach and to modernize a process that has not been changed in nearly a decade. For instance, Senator John Cornyn (R-TX) announced in mid-June 2017 that he is finalizing a bipartisan bill to reach minority investments, foreign joint ventures, and other currently uncovered transactions, largely in an effort to stem Chinese investment in critical US technology. Such transactions currently fall outside CFIUS’ scope. Senator Cornyn has not yet offered the bill for consideration, but if adopted, many more transactions will be submitted for CFIUS review each year. Other reports also suggest that Senator Chuck Schumer (D-NY) and Senator Chuck Grassley (R-IA) are also working on competing bills that would expand CFIUS’ reach.

In the meantime, the [Annual Report to Congress for CY 2015](#) shows that CFIUS continues to scrutinize foreign investments that raise national security concerns, and there has been a significant increase in the number of transactions notified to CFIUS in 2016 and 2017. The Report also encourages parties to transactions that may raise national security concerns to anticipate the need to make a CFIUS filing and progress through the CFIUS review process prior to closing. Indeed, because of the longer timelines for clearing the CFIUS process, parties should consider the CFIUS impact on the transaction as early as possible, including as it relates to the outside date of a transaction and ticking fees in financing arrangements.

Latham & Watkins helps both US companies and foreign investors navigate the complex and interrelated federal regulatory regimes designed to safeguard US national security interests, including through all stages of the CFIUS process — from deciding whether to submit a “voluntary” notice to CFIUS, to drafting the notice and responding to further requests for information, to negotiating a mitigation plan if necessary to address concerns identified during the review.

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