

Client Alert

Latham & Watkins Corporate Department

CFIUS Issues Annual Report for 2011 Discussing National Security Review of Foreign Investment into the United States

The Committee on Foreign Investment in the United States (CFIUS) released the public version of its 2011 Annual Report in late December 2012. (For background on CFIUS, please refer to our prior *Alert*, available at: <http://www.lw.com/thoughtLeadership/cfius-2010-annual-report>. The 2011 Report provides statistics about the notices submitted to CFIUS in connection with investments made by foreign investors in US businesses in 2011, including statistics concerning how many filings triggered investigations or were withdrawn. Although the public version of the report does not include specific information about the transactions at issue, it does offer various insights into foreign investment trends as well as factors CFIUS considers during its national security deliberations.

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2011 saw a continuation of the trend in which a higher percentage of CFIUS filings were subjected to a second-level "investigation" period than in the past, as well as a similar increase in the percentage of transactions subjected to mitigation measures as a condition of clearance. Notably, the 2011 Report marks the first official statement by CFIUS of its general concern that at least one foreign country is probably executing a coordinated strategy to acquire US companies involved in research, development or production of critical technologies for which the United States is a leading producer — which helps to explain the increased rigor of the CFIUS process. We elaborate below on these highlights and some of the more detailed information in the 2011 Report.

Unfortunately, it has long been CFIUS's practice to publish its annual reports almost a full year after the period for which the report is made. Thus, the 2011 Report was published at the very end of 2012 — and 2012 was a very significant year for which public statistics will not be available until the end of 2013. The past 12 months have been characterized by: (1) increasingly probing review of a broader range of transactions across a spectrum of industries; (2) expanded use by CFIUS of the investigation period, which permits CFIUS to continue to evaluate a transaction for up to 45 days after the initial 30-day "review" period has elapsed; (3) more frequent requests that the parties to a notice withdraw and refile that notice to effect a de facto extension of the combined 75-day period for which the statute provides, thus allowing CFIUS more time to consider those transactions; and (4) more aggressive assertion of authority to require mitigation and other measures to address national security concerns. CFIUS's new aggressiveness included the highly public order blocking a Chinese company's acquisition of wind energy farms in Oregon, which

also imposed controversial conditions on the required divestiture. (This order is, as we have previously reported, in litigation in federal court in Washington, D.C. Please refer to our prior *Alert* on this case, available at: <http://www.lw.com/thoughtLeadership/cfius-shows-new-aggressiveness-2012>. We will update our report as events warrant.) Nor was this the only manifestation of CFIUS activism—although it did not become public, there was at least one other transaction in 2012 in which CFIUS issued similar orders.

Here, then — subject to the reality that 2012 has been a substantially more interesting and important year for CFIUS — are the details reported by the government with respect to CFIUS's activities in 2011:

2011 CFIUS Annual Report: Highlights

- The most notable aspect of the 2011 Report is its frankly-stated conclusion, based on its assessment of 2010 activity, that:

The US Intelligence Community (USIC) judges with moderate confidence that there is likely a coordinated strategy among one or more foreign governments or companies to acquire US companies involved in research, development, or production of critical technologies for which the United States is a leading producer.

This observation stands in stark contrast to the prior year's report, in which the USIC's stated judgment was that it was "*unlikely* that there [was such] a coordinated strategy." The "critical technologies" to which CFIUS refers include (1) defense articles and defense services regulated by the US State Department under the International Traffic in Arms Regulations (ITAR); (2) items controlled for national security and other reasons by the US Commerce Department under the Export Administration Regulations; (3) nuclear-related technology and items controlled by the Department of Energy and the Nuclear Regulatory Commission; and (4) select agents and toxins. While the identity of the country or countries involved, and the underlying details, are classified and not included in the published report, our observation of CFIUS reactions to China-related cases as well as our own interactions with government personnel involved in the CFIUS process strongly suggest that the reference in the Report is to China as well as possibly to other countries that are known to have close economic and military ties to China. However, based on our experience and interactions with CFIUS officials, we believe there is also a strong likelihood that CFIUS views certain countries other than China with suspicion in terms of executing coordinated strategies to acquire leading-edge US technologies. This new expression of heightened concern is consistent with the expanded breadth and substantive scope of CFIUS review, as well as the government's stated concern with respect to a number of transactions.

- In 2011, CFIUS agencies required the use of mitigation measures as a condition for clearance in eight different transactions. These transactions encompassed six different sectors of the economy (software, computer programming, computer and electronic manufacturing, electrical equipment and component manufacturing, aerospace manufacturing, and finance), and a total of five different Executive Branch agencies assumed responsibility for monitoring these eight agreements. These statistics demonstrate the expanding breadth of government interest in foreign investment transactions across different industries and executive branch responsibility portfolios.

2011 CFIUS Annual Report: Trends and Statistics

- 2011 saw another increase in the number of filings. In 2011, CFIUS reviewed 111 notices, which represents a 19 percent increase in filings compared to 2010, when CFIUS received 93. In 2009, CFIUS received only 65 notices.
- In 2011, CFIUS initiated an investigation in 40 of the 111 cases before it, representing approximately 36 percent of its caseload. In percentage terms, these numbers are reasonably consistent with the figures from 2009 and 2010.
- Of the 111 filings made in 2011, six were withdrawn — one during the initial 30-day review period and five during the subsequent investigation phase. Of the six withdrawn cases, four were re-filed in 2011, and two were re-filed in 2012.
- In 2011, none of the CFIUS investigations ultimately resulted in a decision by the President — to block or to allow a transaction.
- During the period from 2009 through 2011, CFIUS received a total of 269 notices. Of these filings:
 - o 39 percent (106 notices) related to the manufacturing sector (*i.e.*, computer and electronic products; transportation equipment; electrical equipment, appliances, and components; machinery; chemical; fabricated metal products; primary metal; textile product mills; petroleum and coal products; and plastic and rubber products)
 - o 35 percent (95 notices) related to the finance, information, and services sector (*i.e.*, professional, scientific, and technical services; publishing industries not including Internet publishing; telecommunications; administrative and support staff; securities, commodities contracts, and other financial investments and related activities; credit intermediation and related activities; and waste management and remediation services)
 - o 18 percent (48 notices) related to mining, utilities, and construction (*i.e.*, utilities; support activities for mining; mining not including oil and gas; oil and gas extraction; heavy and civil engineering construction; specialty trade contractors; and building construction)
 - o 7 percent (20 notices) related to wholesale and retail trade and transportation (*i.e.*, support activities for transportation; durable and non-durable goods merchant wholesalers; electronics and appliance stores; water transportation; transit and ground passenger transportation; and pipeline transportation).
- During the period from 2009 through 2011, the United Kingdom accounted for approximately 25 percent of all filings. Canada and France each accounted for approximately 10 percent of notified transactions during this period, while Israel and Japan each accounted for approximately 7 percent.
- In 2011, filings in which a Chinese entity was an acquirer continued to increase. There were ten such filings in 2011, compared to six in 2010 and only four in 2009.
- In 2011, CFIUS continued to make active use of mitigation measures to require businesses to take specific actions to ensure that national security is not impaired as a result of the foreign investment, typically as a condition for approval of the transaction by CFIUS. As noted above, CFIUS agencies negotiated measures for eight different transactions; collectively over time, these mitigation measures included:

- o Establishing a Corporate Security Committee, security officers and other mechanisms to ensure compliance with all required actions, including annual reports and independent audits
- o Ensuring compliance with established guidelines and terms for handling existing or future US government contracts and US government customer information
- o Ensuring only US persons handle certain products and services, and ensuring that certain activities and products are located only in the United States
- o Notifying relevant US government parties in advance of any material introduction, modification, or discontinuation of a product or service, as well as any awareness of any vulnerability or security incidents;
- o Ensuring continued production of certain products for relevant US government parties for specified periods
- o Requiring a proxy entity to perform certain functions and activities of the US business
- CFIUS agencies have also provided in mitigation agreements for a variety of means to monitor and enforce compliance by the companies that are subject to the measures, including:
 - o Periodic reporting to US government agencies by the companies
 - o On-site compliance reviews by US government agencies
 - o Third-party audits when provided for by the terms of the mitigation measures
 - o Investigations and remedial actions if anomalies or breaches are discovered or suspected
- Finally, the Annual Report confirms that there are numerous areas of particular national security concern to CFIUS. They include the following:
 - o Foreign control of US businesses that:
 - Provide products and services to government authorities with national security functions
 - Provide products or services that could expose national security vulnerabilities, including cyber security concerns and/or vulnerability for sabotage or espionage through the US business's position in the supply chain or otherwise
 - Implicate critical infrastructure, such as businesses in the energy sector (including extraction, generation, transmission and distribution), that affect the national transportation system or that directly affect the financial system;
 - Have access to classified or other sensitive US government information;
 - Engage in research and development, production or sale of technology, goods, software or services subject to US export controls;
 - Are in geographic proximity to certain kinds of US government facilities;
 - Are involved in activities related to weapons and munitions manufacturing, aerospace, and radar systems, or that otherwise do business in the defense, security or law enforcement sectors;

- Produce advanced technologies useful to national security, including those engaged in the design and production of semiconductors and other equipment or components with both commercial and military applications, or those involved in telecommunications and network data security; or
- engage in activities subject to US export controls or that have access to classified information.g
- o A record of conduct giving rise to transactions involving foreign persons controlled by a foreign government, from a country with nonproliferation or other national security-related concerns, or with a history of taking or intending to take actions that could impair national security.

In light of the increase in the scope and rigor of CFIUS investigations in 2011, and the acceleration of that trend in 2012, it is important for companies in industries of national security concern, and those that implicate critical infrastructure, communications, information technology, national defense, or US export controls, to anticipate CFIUS investigation and incorporate time for the 30-day CFIUS review and 45-day CFIUS investigation periods into transaction timelines.

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