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Eight Highlights For Dealmakers From CFIUS' Annual Report

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On November 19, 2019, the Committee on Foreign Investment in the United States ("CFIUS") released its long-awaited [annual report](#) covering calendar years 2016 and 2017. While the information in the annual report is dated, the data it contains remains useful.

Among other things, the data demonstrates CFIUS' increasing relevance to cross-border transactions across diverse subsectors, including many that have not widely been considered sensitive (e.g., real estate). Moreover, CFIUS' relevance to such transactions will expand further when the [recently proposed CFIUS regulations](#), published on September 17, 2019, are finalized on or before February 13, 2020.

We discuss below eight important highlights of the annual report and offer related takeaways.

1. There has been a marked increase in the number of transactions notified to CFIUS.

In 2016, CFIUS reviewed 172 joint voluntary notices. In 2017 and 2018, by contrast, CFIUS reviewed 237 and 229 joint voluntary notices, respectively.

Of note, the slight dip in joint voluntary notices for 2018 conceals an increase in the true number of submissions: CFIUS' [critical technology pilot program](#), which became effective in November 2018, yielded over a dozen submissions prior to the end of the 2018 calendar year that are not included in the 229 number.

2. A historic number of transactions were abandoned due to the parties' inability or unwillingness to address CFIUS' identified national security concerns.

About 10% of all joint voluntary notices filed in 2017 (i.e., 24 of 237) were withdrawn and the underlying transactions were abandoned in light of CFIUS' identified national security concerns. In these 24 cases, the transaction parties withdrew their notices and abandoned the transactions in one of two situations: (1) after CFIUS informed the parties that it was unable to identify mitigation measures to resolve its national security concerns and was prepared to refer the matter to the president; or (2) CFIUS proposed mitigation measures to address its national security concerns, but the parties were unwilling to accept such measures.

By contrast, in 2016, just 1.7% of joint voluntary notices (i.e., three of 172) were withdrawn and the transactions abandoned based on CFIUS' national security concerns.

3. CFIUS required one new — at the time — mitigation measure to address identified national security risks.

This involved a requirement that transaction parties prohibit or limit "the transfer or sharing of certain intellectual property, trade secrets, or know-how."

The annual report further noted that CFIUS monitors compliance with mitigation agreements through a variety of mechanisms, including assigning staff responsibilities for the compliance monitoring, designing tracking systems to monitor required reports, and instituting internal instructions and procedures to ensure that in-house expertise is drawn upon to analyze compliance with agreed-upon mitigation measures.

4. Extended case review timelines are the new normal.

By statute, all cases notified to CFIUS must undergo an initial 45-day review period. In certain cases (e.g., when the acquirer is foreign government-controlled or is in front of CFIUS for the first time), a subsequent investigation phase of 45 days is required, absent a waiver.

CFIUS' statistics show a significant increase in the number of transactions for which CFIUS undertook a 45-day investigation.

Year	Total Notices	Investigations
2018	229	159 (69% of notices)
2017	237	172 (72.5% of notices)
2016	172	79 (46% of notices)
2015	143	66 (46% of notices)

5. CFIUS remains keenly interested in reviewing transactions with a nexus to China.

As of 2017, transactions involving Chinese acquirers constituted the largest single category of all joint voluntary notices filed with CFIUS for the sixth year in a row.

In 2017, the top five countries of origin for acquirers were as follows:

2017 Rank	Country	Notices Filed in 2017
1	China	60
2	Canada	22
3	Japan	20
4	United Kingdom	18
5	France	14

6. CFIUS is increasingly concerned about third-party risks arising from a prospective buyer's unrelated commercial relationships with risky foreign countries or parties.

The annual report included two new perceived adverse effects of covered transactions that have not appeared in prior years' annual reports. These were:

- A determination that the transaction could facilitate the transfer of U.S. export-controlled technologies, including semiconductors, biotechnology, weapons/munitions, aerospace, satellite, radar systems and cyber technologies, to "third parties not directly related to the buyer, to the detriment of national security"; and
- A determination that a transaction could "otherwise facilitate foreign intelligence collection against U.S. targets."

7. CFIUS continues to be focused on addressing risks arising from access to personal data.

Consistent with its conclusion in the 2015 annual report, CFIUS included in its discussion of potential adverse effects of covered transactions a determination that the U.S. business "hold[s] substantial pools of potentially sensitive data about U.S. persons and businesses that have national security importance."

While this concern may be most acute in health care transactions involving companies that collect and store significant amounts of personal identifier information, it can also be present in transactions involving technology and software companies, among others.

8. The U.S. Intelligence Community determined that foreign governments are “extremely likely to use a range of collection methods to obtain critical U.S. technologies.”

Each annual report since 2009 has expressed the same conclusion.

Takeaways

- **Consider CFIUS early in the transaction planning process.** A CFIUS filing can have significant impacts on a transaction, including with respect to efforts standards in purchase agreements, potential outside dates and financing.
- **Anticipate longer CFIUS reviews when assessing transaction timing.** Fewer CFIUS reviews are clearing in the initial 45-day review period. The annual report reveals that approximately 70% of CFIUS cases in 2017-2018 extended into the additional 45-day investigation phase. As a result, parties should prepare for a four- to six-month process from the submission of the draft notice to the resolution of the case (i.e., clearance), even if the parties believe the transaction is completely benign.
- **Buy-side self due diligence is critical.** Prospective foreign acquirers should carefully evaluate how CFIUS may view their independent value-chain exposure to countries and parties that CFIUS may consider risky (e.g., through joint ventures or commercial relationships in China or Russia). U.S. private equity sponsors considering syndication should also consider the CFIUS risk profiles of potential co-investors.
- **New regulations on the horizon may make a difference.** The CFIUS environment is far from static. When new CFIUS regulations become effective in early 2020, certain transactions involving foreign government-controlled investors (e.g., sovereign wealth funds) will be subject to mandatory CFIUS filing requirements. CFIUS has indicated that the final regulations will exempt certain categories of foreign investors from CFIUS’ new jurisdiction over certain noncontrolling, nonpassive investments by such foreign investors.

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