

## CFIUS Releases its 2019 Annual Report — Key Points for Dealmakers

12 August 2020

On July 30, 2020, the Committee on Foreign Investment in the United States (“CFIUS”) published its Annual Report to Congress detailing the transactions it reviewed during calendar year 2019. The Annual Report follows closely after CFIUS’ release of its 2018 report in May 2020, fulfilling CFIUS’ ongoing effort to bring its reporting requirements current. The Annual Report is also notably more detailed than past reports, providing new information required by the Foreign Investment Risk Review Modernization Act of 2018 (“FIRRMA”), [which strengthened and modernized CFIUS’ operations](#). Thus, in addition to the several notable insights contained in the report, the issuance of the Annual Report itself is a noteworthy milestone.

The Annual Report is further evidence that CFIUS’ activities have continued apace despite challenges posed by the global COVID-19 pandemic. During the pandemic, CFIUS has rolled out a new case management system, provided a geographic research tool to help parties identify when real estate may be located in proximity to sensitive U.S. government facilities, issued two annual reports, implemented a new filing-fee process and further implemented CFIUS reform through additional rulemakings. In the near future, CFIUS is also expected to issue its first-ever enforcement guidance and to finalize its [rulemaking on the scope of mandatory filings for critical technology transactions](#), which will be focused on the export licensing requirements associated with the technology at issue. This activity – in addition to handling the Committee’s normal caseload, which has recently included several high-profile matters – reflects the continued expansion and institutionalization of CFIUS’ resources, staff, operations and processes.

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## **the scope of mandatory filings for critical technology transactions, which will be focused on the export licensing requirements associated with the technology at issue.**

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Here are key takeaways for dealmakers from the Annual Report.

### 1. CFIUS' caseload continues to grow ...

Over the past decade, the annual number of filings that parties made seeking CFIUS approval has more than doubled. The Committee now reviews well over 200 long-form, joint voluntary notices ("JVNs") each year. Although the number of JVNs filed in 2019 reflected only a slight increase over those filed in 2018 (231 to 229, respectively) and was actually slightly less than 2017's record 237 cases, 2019 also saw the filing of 94 short-form "declarations." Thus, in the aggregate, 2019 saw far more CFIUS actions – 325 – than any other year in CFIUS' history.<sup>1</sup>

Accounting for the pandemic and its effects on M&A and investment activity, over the long term, we expect this growth trend will continue because, beginning in 2020, new categories of covered transactions and mandatory filings will have come into effect. With [CFIUS' January 2020 regulations implementing FIRRMA](#), certain non-controlling investments and real estate transactions that were not covered previously are now "covered transactions" and subject to CFIUS review. In addition, transactions that would involve a foreign government obtaining a "substantial interest" in certain U.S. businesses now join critical technology transactions as requiring mandatory pre-closing CFIUS filings. Lastly, the scope of mandatory filings for critical technology transactions is also likely to increase over the long term with the expected issuance of final rules for mandatory filings of non-passive foreign investments in U.S. critical technology companies and the continued efforts by the Department of Commerce to define and identify "emerging" and "foundational" technologies, which will then be adopted by CFIUS as new forms of "critical technology."

### 2. ... however, CFIUS is becoming more efficient in its reviews.

FIRRMA expanded the overall CFIUS timeline to 90 calendar days by lengthening the first stage of the process (the "review" stage) from 30 to 45 calendar days. Treasury noted that it expected the added time in the review stage to enable CFIUS to clear more cases in review. In other words, a case that under the pre-FIRRMA timeline might not clear in the 30-day review but would clear in the second-stage, 45-day

“investigation” would take 75 days in the process overall. With the added time up front, the same case might clear in 45 days, saving transaction parties up to 30 days.

If 2019 indicates the beginning of a new trend, then this argument for a longer initial review period appears to be borne out: In 2019, more than half of the 231 JVN's cleared in review, compared to just under one-third in 2018, when the 30-day review period was still in effect for the first eight months of the year. What's more, CFIUS also appears to have achieved its goal of reducing the number of withdrawals and refilings, i.e., a voluntary restarting of the “clock” by the parties: In 2019, there were only 30 withdrawals compared to 64 in 2018. In addition, despite extenuating circumstances in some individual cases, CFIUS dealt with the pre-filing process for transactions efficiently over the past year. For JVN's, CFIUS on average provided comments within about 11 business days of receiving a draft and accepted the final JVN within about eight business days of receiving it. Taken together, 2019 represented a substantial improvement in timelines for obtaining CFIUS clearance and bodes well for more efficient reviews in the coming year.

### 3. Enough data to begin to form judgments on declarations ...

With 94 declarations reviewed in 2019, parties now have a more significant dataset to draw some initial conclusions about the declaration process created under FIRRMA. Of the 94 declarations submitted in 2019, only 35 were cleared (i.e., received full CFIUS approval), with another 32 resulting in a notification to the parties that the Committee was unable to complete its review of the transaction (colloquially referred to as a “shoulder shrug” response), and the remaining 26 with a request that the parties file a full JVN. Depending on a party's appetite for living with an indefinite answer from CFIUS, i.e., a “shoulder shrug” response, these results present either a mixed picture or a negative one. However, even viewing the shoulder shrug as an acceptable outcome, nearly one-third of all declarations resulted in CFIUS requesting a notice.

Given that a request to file a JVN after submitting a declaration can at best introduce significant uncertainty into the CFIUS process and at worst be disastrous for a deal where timing is crucial, for certain transaction parties, the risks of the declaration process may outweigh its potential benefits.

### 4. ... but questions about declarations still remain, and there is room for optimism in certain cases.

It is important to keep in mind that the declaration process in 2019 was available for only mandatory “critical technology” filings, which, by definition, involve foreign investments in U.S. businesses with export-controlled technologies that are engaged

in one of 26 industries that CFIUS had identified as being particularly sensitive within the entire U.S. economy. In other words, the 2019 data set comprises transactions that are more “sensitive” from a CFIUS perspective. Beginning in 2020, the declaration process became available for voluntary filings as well, i.e., any covered transaction, regardless of industry or the presence of export-controlled technology.

Although there are no statistics yet available for filings in 2020, it appears likely that clearance rates for voluntary declarations may exceed those for declarations involving transactions subject to a mandatory filing requirement. As such, the declaration process may be a viable option for relatively low-risk transactions – particularly involving buyers that have recently received CFIUS clearance on other transactions – to receive an even faster clearance than they would be able to obtain by clearing in the first stage of the long-form JVN process. Further, despite the number of declarations that resulted in a JVN request, nearly one-third of declarations last year were cleared outright, indicating that the declaration process may be used more broadly by certain lower-risk buyers, even for transactions involving potentially sensitive sectors.

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Parties will need to consider carefully the pros and cons of the two paths through the CFIUS process, with the declaration process (which, in addition to being potentially faster than a JVN, also does not come with the filing fees required for a JVN) offering a potentially higher risk-reward outcome. Nevertheless, the long-form JVN process is likely to remain the better approach for many transactions involving U.S. businesses with a more significant nexus to U.S. national security.

## 5. China is no longer the leading source of filings ...

After many months of headlines dominated by news of [tense trade relations between the U.S. and China](#), along with efforts by Congress and the executive branch to curtail Chinese hacking, intellectual property theft and other activities targeting American

innovation (including several noteworthy actions by CFIUS), it comes as no surprise that JVN filings by Chinese entities dropped precipitously over the past couple of years. Compared with 60 JVN filings by Chinese buyers in 2017 and 55 JVN filings by Chinese buyers in 2018, there were only 25 JVN filings and three declarations filed by Chinese buyers in 2019. In fact, 2019 was the first year since 2011 that China was not the single-largest source of transactions notified to CFIUS.

This number could be expected to drop further in 2020 following recent high-profile divestments by CFIUS and a steep decline in Chinese investment into the U.S. Although it is likely that several factors influenced this trend – including the possibility that some companies chose to take the risk of not filing for approval and proceeding without a regulatory safe harbor – it is likely that the intense scrutiny of Chinese investors played a key role.

Importantly though, based on the statistics provided by CFIUS regarding withdrawals and abandonments, at least some Chinese investors' transactions were approved – potentially with mitigation, or based on a determination that the relevant U.S. business presented no discernible national security vulnerabilities.

As it has become more difficult for Chinese companies to complete sensitive investments in the U.S., other Asian countries are increasingly seeking approval for transactions that implicate CFIUS. Indeed, Japan, a country that was in large part responsible for the strengthening of CFIUS in the 1980s, was the largest source of filings in 2019. In 2019, Japanese companies' 46 JVN filings more than doubled its 2017 number, and 2019 also saw 19 critical technology declarations filed by Japanese investors. In fact, Japan represented the largest number of acquisitions implicating critical technology in 2019. Other Asian countries that appreciably increased their CFIUS activity were non-mainland Hong Kong and Taiwan as well as South Korea and Singapore.<sup>2</sup>

6. ... however, connections to China are a key focus of most reviews.

Although China has become a source of significantly fewer transactions reviewed by CFIUS, it nonetheless remains a key focus of most CFIUS reviews. CFIUS has increasingly scrutinized foreign investors' connections to China, including investors' operations in China, Chinese customers, Chinese vendors and overall use of and reliance on the Chinese supply chain. With its focus on supply chains and supply assurance, particularly in connection with medical technology, CFIUS is returning to its roots as a core component of ensuring the nation's industrial base capabilities. In the investment funds context, CFIUS frequently asks many searching questions regarding

Chinese limited partners and co-investors. Moreover, as discussed further below, CFIUS has acted in a number of cases to mitigate potential threats posed by China even where the investor or acquirer is not itself a Chinese entity. Accordingly, it is important for dealmakers to identify Chinese connections early in the diligence process.

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7. CFIUS continues to require mitigation agreements for sensitive transactions.

When CFIUS reviews a transaction, it generally can (i) approve the transaction, (ii) block the transaction (or, in the case of a closed transaction, force a divestment), or (iii) approve the transaction subject to the parties' acceptance of conditions in a mitigation agreement. Newly expanded hiring authority and resources under FIRRMA have helped CFIUS grow its capacity to enter into and enforce mitigation agreements.

In 2019, CFIUS adopted mitigation measures with respect to 33 JVN's. Of those, 28 were cleared as a result of entering into a mitigation agreement. For the other five, CFIUS placed conditions on parties that were in the process of abandoning a transaction. Mitigation agreements required parties to agree to a wide variety of measures. Although not explicitly stated, many of these measures are designed to limit the ability of the foreign investor or acquirer to move operations, resources or data to China, or to enable access to sensitive networks or information from China.

Examples of mitigation terms identified in the report include:

- Prohibitions on the sharing of intellectual property and trade secrets,
- Placing conditions on the use of U.S. government customer information,
- Requiring certain activities to be performed in the U.S.,
- Requiring certain governance and oversight protocols, and
- Requiring notifications of the change in ownership to customers.

With these new resources and increasing CFIUS outreach on non-notified transactions, we expect CFIUS to continue entering into new mitigation agreements and, potentially, divestment orders in the year ahead.

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1. Declarations were not available before 2018.↔

2. Hong Kong and Taiwan each made no filings in 2017 and four in 2019; and South Korea and Singapore each made six filings in 2017 and 10 in 2019. For declarations, Hong Kong led one, Taiwan led two, South Korea led nine and Singapore led four in 2019.↔

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