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Kirkland Alert

## Highlights From CFIUS' Latest Annual Report

14 August 2023

On July 31, 2023, the Committee on Foreign Investment in the United States (“CFIUS” or the “Committee”) released its [annual report](#) covering calendar year 2022 (the “Annual Report”). 2022 was a landmark year for CFIUS with the issuance of its [first-ever guidelines pertaining to enforcement](#) actions and the [first presidential executive order directing CFIUS to consider certain risk factors when reviewing transactions](#), among other actions such as granting “excepted investor” status to New Zealand (joining Australia, Canada and the United Kingdom). While the enforcement guidelines and executive order did not alter CFIUS’ legal authority, they were important signals to market participants on how CFIUS is thinking about transactions. The Annual Report offers further insight into important CFIUS trends.

CFIUS formally reviewed a record-high number of long-form notices and short-form declarations, 440 in total, and continued its “non-notified” outreach regarding transactions that were not filed proactively by parties. With 2022 being the busiest year on record for the Committee, we also saw increasing mitigation rates as well as decreasing clearance rates for short-form declarations. Given the importance of transaction certainty and timing in today’s competitive M&A and debt financing market, CFIUS will continue to be an important gating item for dealmakers to consider.

We discuss below six important highlights of the Annual Report and offer related takeaways.

**1. The total number of CFIUS joint voluntary notices (“JVNs”) reached record highs for the second year in a row; however, the rate of clearance in the first review period fell.**

Notwithstanding a global slowdown in M&A during 2022, the total number of JVN<sup>s</sup> filed with CFIUS reached a 10-year high (286). Coinciding with this high number of cases and CFIUS' increased workload, there was a material drop in the rate of JVN<sup>s</sup> cleared in the first 45-day period of CFIUS' review. While clearance during the initial 45-day review period generally remains achievable for straightforward cases, the Committee is opting to push JVN<sup>s</sup> to a second 45-day "investigation" period more frequently than in past years, in part because CFIUS is imposing mitigation on more transactions. *We expect this trend to continue through 2023 and recommend transaction parties account for the higher likelihood of a second 45-day period when evaluating deal timing.*

<i>Year</i>	<i>Total JVN<sup>s</sup></i>	<i>Clearance During Review</i>
2022	286	123 (43% of JVN <sup>s</sup> )
2021	272	140 (51% of JVN <sup>s</sup> )
2020	187	98 (52% of JVN <sup>s</sup> )
2019	231	118 (51% of JVN <sup>s</sup> )

## **2. CFIUS is imposing "mitigation" conditions on transaction parties more frequently.**

If CFIUS identifies national security concerns arising from a transaction within its legal jurisdiction, CFIUS may condition its approval of a deal on transaction parties' acceptance of certain conditions. CFIUS concluded action after imposing mitigation measures on 41 JVN<sup>s</sup>, or approximately 23% of the distinct transactions filed in 2022, representing a material increase from prior years.<sup>1</sup> In addition, CFIUS adopted mitigation agreements for three JVN<sup>s</sup> that were withdrawn and abandoned to address residual national security concerns. CFIUS is not required to wait until a mitigation agreement is fully negotiated to impose conditions on the parties; during 2022, CFIUS imposed measures to mitigate so-called "interim" risks with respect to three transactions.

When it becomes clear that CFIUS will not approve a deal, transaction parties usually withdraw and abandon a transaction prior to it being referred to the U.S. president. While no transactions were formally prohibited by order of the president in 2022, there were 12 instances where parties withdrew and abandoned the transaction after CFIUS

was either unable to identify mitigation measures sufficient to resolve national security concerns, or unable to identify mitigation measures that the parties would accept. In another eight instances, parties withdrew and abandoned the transaction due to commercial reasons.

<i>Outcome</i>	<i>Number of JVNs</i>	<i>% of Distinct JVNs</i>	<i>% of Total JVNs</i>
Approved, but conditioned on the parties' acceptance of mitigation measures	41	23%	14%
Withdrawn and the underlying transaction abandoned	20	11%	7%
Prohibited by the president	0	0%	0%
<b>Total</b>	<b>61</b>	<b>34%</b>	<b>21%</b>

Notably, the Annual Report does not provide any information regarding the types of mitigation agreements imposed – i.e., whether the mitigation reflects more narrow mitigation requirements, such as supply assurances, or reflects an increase in mitigation that would have material impacts on foreign investors and transactions. With that said, the Annual Report provides a non-exhaustive list of example mitigation measures, for which two new measures were added: “*requiring prior notification to and non-objection by the U.S. Government regarding changes to data storage locations*” and “*restricting recruitment and hiring of certain personnel.*” This first measure relates directly to CFIUS’ increased focus on transactions implicating access to sensitive U.S. person data as also observed in the 2022 executive order and foreshadowed by the 2021 Annual Report.

**3. CFIUS is increasing its focus on monitoring and enforcement, including efforts to monitor ongoing compliance with mitigation agreements.**

The Annual Report notes that 214 mitigation agreements and conditions are currently being monitored by CFIUS and that CFIUS conducted 44 site visits to verify compliance with agreements, as compared to 187 agreements and 29 site visits in 2021. The Annual Report includes multiple references throughout regarding increased hiring and devotion of resources to compliance. Additionally, during 2022 and

continuing into 2023, CFIUS held a number of meetings with third-party compliance monitors and auditors to discuss CFIUS' expectations with respect to mitigation requirements.

While the Committee did not assess or impose penalties or initiate a unilateral review of a transaction during 2022 (and CFIUS last reported a penalty in 2019), we expect enforcement to be a key area of focus for CFIUS going forward, particularly in light of CFIUS publishing enforcement guidelines designed, in part, to give notice to transaction parties regarding circumstances that can give rise to CFIUS enforcement actions. Senior CFIUS staff have indicated that there have been several enforcement actions by CFIUS (potentially in 2023), though no details have yet been made public.

#### **4. While CFIUS' non-notified outreach has decreased overall, such outreach is increasingly focused on recent transactions.**

So-called "non-notified" reviews – i.e., inquiries by CFIUS into transactions that were not proactively filed with the Committee – continue to be an important part of CFIUS' mandate. CFIUS identifies non-notified transactions through a variety of methods, including, among others, interagency referrals, tips from the public, media reports, companies' own press releases, commercial databases, SEC and other regulatory filings, and congressional inquiries.

Despite a decreasing number of non-notified transactions identified and put forward to the Committee for its consideration (84) as compared to 2021 (135), more than 99% of these transactions occurred post-FIRRMA<sup>2</sup> (as compared to 74% in 2021 and 20% in 2020), suggesting that CFIUS has, to some degree, been "catching up" on old transactions. Additionally, the Annual Report notes that CFIUS requested JVN's for 11 of the 84 transactions identified in 2022 and that eight JVN's were requested in 2022 for transactions first identified in prior calendar years.

Notably, in addition to the usual references that the Committee is seeking to increase resources devoted to its non-notified team, the Annual Report included commentary that the team has "*become more sophisticated in its approach*" and that "*[t]ransactions that originate through the non-notified process remain among the most complicated that CFIUS considers [and] often require mitigation measures to address national security risks.*"

While the data appears relatively stable over the past several years in terms of transactions identified and JVN's requested, the data combined with the updated commentary again are strong indications that CFIUS intends to continue to be active

in identifying non-notified transactions. Importantly, this data does not reflect the full picture – in particular, the numbers do not account for:

(i) cases where parties filed a JVN after CFIUS’ initial outreach but prior to receiving a formal request to make a filing,

(ii) JVNs that may have been requested (or will be requested) from this batch of 2022 non-notified transactions post-2022,

(iii) the number of JVNs that resulted in mitigation out of the 19 total JVNs requested, or

(iv) the “*thousands*” of other transactions considered by CFIUS as potential non-notified transactions that did not result in a filing.<sup>3</sup>

**5. The short-form declaration process appears to have become a less popular option in 2022, likely because a notable shift in agency practice in early 2022 resulted in almost half of the declarations failing to clear at the end of the assessment period.**

The Annual Report reveals a slight decrease in the total number of declarations filed in 2022 (154) as compared to 2021 (164); however, the percentage of declarations as compared to total filings fell from 37% in 2021 to 34% in 2022 indicating transaction parties may have more often opted to start with a JVN rather than trying to clear on a declaration. This shift was likely in response to a material increase in the number of declarations for which a JVN was requested (32% in 2022 as compared to 18% in 2021).

<i>Outcome</i>	<i>Number of Declarations (2022)</i>	<i>% of Total Declarations (2022)</i>	<i>Number of Declarations (2021)</i>	<i>% of Total Declarations (2021)</i>
Cleared	90	58%	120	73%
JVN Requested	50	32%	30	18%
Unable to Complete Action,	14	9%	12	7%

but no JVN Requested				
Withdrawn	0	N/A	0	N/A
Rejected	0	N/A	2*	1%

\*Inclusive of one declaration that was refiled as a JVN.

Notably, the decrease in clearance rate cannot be explained by material changes in the home country of acquirers choosing to file declaration, which has remained relatively stable since 2020. In 2022, as was the case with 2021 and 2020, investors from U.S. partners and allies (e.g., Canada, Japan, the UK and Germany) accounted for a majority of the declarations submitted to CFIUS, with Canada and Japan accounting for the largest numbers of declaration submissions (22 and 18, respectively). While not reflected in the Annual Report, it is likely that the decrease in clearance rates were, at least in part, a result of staffing changes at CFIUS member agencies.

As such, the short-form declaration continues to be a viable option for certain types of transactions but is not without risk that the overall CFIUS timeline becomes protracted, and whether a declaration is appropriate should be carefully considered on a transaction-by-transaction basis. Almost one in three declarations resulted in a request for a long-form JVN, meaning that, for many of these transactions, the CFIUS process was extended by another several months, and likely well beyond the CFIUS timeline that would have resulted from beginning with a JVN. Although the declaration continues to provide a potentially faster timeline and reprieve from filing fees, parties should evaluate (i) the risk of a declaration culminating in a request for a JVN when timing presents a deal issue and (ii) whether the parties are comfortable with closing a transaction without having first received CFIUS' "safe harbor."

**6. Investors from U.S. security partners and allies continue to account for an increasing proportion of filings; however, Chinese transaction parties remain active.**

As shown in the following table, the number of CFIUS filings with Singaporean parties nearly doubled and topped the list of countries filing with CFIUS in 2022 (JVNs plus short-form declarations). This is a trend we expect to continue.

<i>2022 Rank</i>	<i>Country</i>	<i>Total Filings in 2022</i>	<i>Total Filings in 2021</i>	<i>Total Filings in</i>
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				<i>2020</i>
1	Singapore	46	24	14
2	China/Hong Kong	41	45	26
3	Canada	39	50	31
3	Japan	33	37	37
5	United Kingdom and British territories	26	23	38
6	South Korea	25	24	6
7	France	23	22	16
7	Germany	23	21	17
9	Sweden	13	8	17
9	UAE	13	2	5
–	<i>All Others</i>	<i>158</i>	<i>180</i>	<i>106</i>

Though China remains a key focus of concern for many CFIUS reviews and CFIUS continues to scrutinize all foreign investors' ties to adversarial countries – particularly China and Russia (which filed only a single JVN in 2022) – it appears for the second year in a row that many of the China/Hong Kong JVN's were approved, with or without mitigation based on the clearance rates and low number of JVN's that were withdrawn and abandoned. This trend is particularly relevant for private equity funds and consortiums that consider including minority Chinese investors in their acquisition strategy. However, it is important to note that the Annual Report does not (i) provide data on how many China/Hong Kong JVN's were mitigated and the extent of such mitigation; (ii) how many of these JVN's were not resolved in 2022 but rather were withdrawn and refiled multiple times extending into 2023; and (iii) the nature of the China/Hong Kong investments (e.g., minority investments in non-sensitive companies).

## Takeaways

- As in years past, CFIUS reviewed a record number of filings, and CFIUS continues to play an outsized role in dealmakers' approaches to structuring a transaction.
- CFIUS is imposing mitigation conditions more frequently – increasingly directed at minority co-investment from foreign-government controlled investors, while simultaneously ramping up monitoring and enforcement efforts.
- The potential for non-notified outreach, including during a deal's interim period, remains a key consideration in assessing whether a CFIUS filing is warranted. Parties who choose not to file a transaction with national security sensitivities may later find themselves negotiating mitigation terms on the back foot and may face more restrictive measures.
- While there was only one real estate JVN in 2022, we expect real estate to be an area of focus for CFIUS moving forward, including in the non-notified context, given the [current landscape](#), which includes significant congressional attention.

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1. Note that we refer to "distinct transactions" because some transactions relate to more than filing (e.g., a JVN that is withdrawn and refiled one or more times to allow the parties more time to negotiate a mitigation agreement).↩

2. The Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA") was enacted in August 2018 and its [final implementing regulations](#) became effective in February 2020.↩

3. Note, CFIUS has no deadline to consider non-notified transactions. A transaction that does not trigger prompt CFIUS outreach remains reviewable in the future. Increased CFIUS resources or changes in U.S. national security policy priorities, among other things, could arise in a later request for review. ↩

## Authors

Mario Mancuso, P.C.

Partner / Washington, D.C. / New York

Ivan A. Schlager, P.C.

Partner / Washington, D.C.

Daniel J. Gerkin

Partner / Washington, D.C.



Lucille Hague

Partner / Washington, D.C.

Nathan L. Mitchell

Partner / Washington, D.C.

Brad Dumbacher

Associate / Washington, D.C.

Erika Krum

Associate / Washington, D.C.

William G. Phalen

Associate / Boston

Michelle A. Weinbaum

Associate / Washington, D.C.

## Related Services

### Practices

- International Trade & National Security

## Suggested Reading

- 31 October 2022 Kirkland Alert CFIUS Releases First-Ever Enforcement Guidelines
- 21 September 2022 Kirkland Alert President Biden Issues First-Ever Directive to CFIUS on National Security Considerations in Transactions
- 15 August 2022 Kirkland Alert Committee on Foreign Investment in the United States Releases 2021 Annual Report

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