CFIUS Latest Annual Report Reveals Key Enforcement Trends

By **Michael Lowell, Sarah Wronsky, Paula Salamoun and Courtney Fisher**

Michael Lowell

Sarah Wronsky

Paula Salamoun

Courtney Fisher

The most recent annual report from the Committee on Foreign Investment in the United States to Congress covers the 229 notices and 21 declarations that were filed for CFIUS' review in the 2018 calendar year.

The report also provides initial insight on the effects of the Foreign Investment Risk Review Modernization Act of 2018 and recent regulatory changes, while confirming the continuation of other trends in CFIUS practice.

CFIUS is an interagency committee authorized to review certain transactions involving foreign investment in the U.S. and the effect of those transactions on U.S. national security.

The committee is required under Section 721(m) of the Defense Production Act of 1950, as amended by FIRRMA, to provide an annual report to Congress containing, among other things, specific, cumulative and trend information related to transaction filings.

In addition to the recent release of its 2018 annual report, CFIUS also separately released a summary of data for covered transactions for the years 2015 through 2019, providing the first glimpse into statistics surrounding CFIUS filings for the 2019 calendar year.

A summary of the filing data provided in these reports is set forth in the following table:

Year	Notices Reviewed	Investigations Conducted	Cleared but Mitigation Required	Notices Withdrawn and Refiled	Notices Withdrawn and Abandoned	Rejected	Referred to President
2015	143	66	11	9	4	1	0
2016	172	79	17	15	12	0	1
2017	237	172	29	44	30	0	1
2018	229	158	29	42	24	2	1
2019	*231*	*111*	*Not Yet Available*	*18*	*12*	*1*	*1*

We discuss five takeaways and trends from the 2018 annual report below.

1. FIRRMA's extension of the review period allowed CFIUS to clear more transactions without investigation and to continue this trend into 2019.

FIRRMA, the long-overdue legislative overhaul designed to strengthen and modernize the ability of CFIUS to protect national security, was enacted on Aug. 13, 2018. Some provisions of the legislation took effect immediately, while others were implemented at later dates.

The implementation of FIRRMA was completed on Feb. 13.[1] Not surprisingly, this midyear change in regulations and procedures had some immediate impact on filings, as reflected in

the 2018 annual report data.

Prior to FIRRMA, CFIUS was required to complete a review of a notified transaction within 30 days, followed by, if necessary, an investigation period lasting up to 45 days if CFIUS needed additional time to complete its assessment of the transaction.

In practice, the short 30-day review period meant that the overwhelming majority of cases were being held open for the second, 45-day investigation phase. Between 2017 and Aug. 12, 2018, an average of 74% of cases proceeded to the investigation phase.

Moreover, CFIUS on average did not complete its investigation until the last day of the statutory period, meaning most transactions during that period faced the full statutory period of 75 days or longer before receiving clearance to close.

Beginning Aug. 13, 2018, FIRRMA extended the CFIUS statutory review period from 30 to 45 days. This extension appears to have helped CFIUS clear more transactions during that initial procedural window. In comparison to earlier months, the percentage of cases advancing to investigation dropped significantly, with the 2018 annual report showing that only 53% proceeded to investigation after this change was made.

Similarly, initial data for 2019 shows that only 48% of notices proceeded to investigation. This is a remarkable change year-over-year and, when considered in context with the expansion to make short-form declarations available for all transactions, there is reason to be optimistic that the overall CFIUS timeline may become shorter for many transactions.

2. Early pilot program data confirms initial low rate of success on declarations, but parties should note improvements since that time.

FIRRMA expanded the scope of transactions that CFIUS is authorized to review to include non-controlling foreign investment in certain U.S. businesses related to critical technologies, critical infrastructure and sensitive personal data, as well as certain real estate transactions.

Before the U.S. Department of the Treasury fully implemented those portions of FIRRMA in 2020, it commenced a so-called pilot program of temporary regulations on Nov. 10, 2018, mandating that parties notify CFIUS of certain transactions involving a U.S. business that produces, designs, tests, manufactures, fabricates or develops one or more critical technologies.

The pilot program subjected transaction parties to steep penalties for failing to comply with such mandatory filing requirements.

In connection with the pilot program, CFIUS introduced the use of an abbreviated declaration form available for notification of those investments within the scope of the program. Instead of the 45-day statutory review and investigation periods applicable to written notices, the pilot program imposed a shorter assessment period for declarations, requiring CFIUS to take one of the following actions with respect to the declaration within 30 days:

- Notify the parties that CFIUS has concluded all action under Section 721, meaning that CFIUS cleared the transaction;

- Request that the parties file a formal written notice, subjecting the parties to additional statutory periods to allow CFIUS to review and potentially investigate the transaction;

- Inform the parties that the committee is unable to complete action upon the declaration, leaving it to the parties to decide whether to voluntarily submit a written notice to CFIUS in hopes of obtaining clearance or to proceed without further action from the committee; or

- Initiate a unilateral review of the transaction.

In 2018, CFIUS conducted an assessment of 21 declarations that CFIUS determined to be covered transactions subject to its jurisdiction. Twelve of those declarations involved noncontrolling investments in critical technologies, while the remaining nine involved transactions that would result in foreign control of the U.S. business.

Out of the 21 declarations assessed, CFIUS cleared only two transactions on the basis of the declaration. In five cases, it asked the parties to file a written notice with the committee.

CFIUS was unable to conclude action on 11 other declarations. CFIUS also found that one declaration filed was not subject to pilot program jurisdiction.

This data confirms the low declaration success rate that CFIUS shared anecdotally following the commencement of the pilot program.

Despite these initial numbers, however, parties should note that in the last 12 months CFIUS has significantly increased and devoted resources to reviewing declarations. Today, the use of a declaration can be an efficient means to obtain CFIUS clearance in appropriate cases, such as in benign transactions unlikely to raise national security concerns.

3. Foreign investors — and their parents — should note mitigation measures continue to impact a significant proportion of transactions.

At least[2] one quarter of all transactions notified to CFIUS in 2018 faced barriers to closing as a result of national security concerns, and a portion of these transactions resulted in an insurmountable barrier. The report discloses that 12.6% of notified transactions — continuing an upward trend — received CFIUS clearance only after the parties adopted mitigation measures to resolve the committee's national security concerns.

More concerning is the information in the report indicating that approximately 10% of notified transactions did not survive CFIUS review at all — either the transaction parties refused to accept the mitigation measures CFIUS required to clear the transaction, or CFIUS was unable to identify any mitigation measures that would resolve its concerns.

The 2018 annual report provides a list of examples of mitigation measures negotiated and adopted in 2018, which mirrors the examples provided in the 2017 annual report. In practice, the committee may propose a range of mitigation measures depending on the

circumstances of the transaction, including any one or combination of the following measures, among others:

- Restrictions on foreign person access to sensitive data and information;

- Separation of products, services and facilities between the U.S. business and the foreign party;

- Appointment of external auditors and compliance monitors to oversee the parties' mitigation requirements and to report information to U.S. government agencies;

- Appointment of resources within the U.S. business, such as security officers, board members and committees, to provide internal oversight and security monitoring;

- Notification requirements to inform customers of foreign ownership of the U.S. business;

- Supply assurances to the U.S. government regarding performance of existing or future government contracts;

- Adoption of enhanced export compliance and security programs and other policies within the U.S. business; and, in extreme cases,

- Divestiture or exclusion of sensitive assets of the U.S. business from the transaction.

Some of these mitigation measures may be easy for the parties to accept and will not interfere with the objectives of the transaction, while others can disrupt underlying transaction objectives aimed at efficiency, information-sharing, coordinated development and economies of scale between the parties.

Parties should understand at the outset of a CFIUS matter how mitigation measures of the type described in the report could affect the value of the transaction and should consider those implications both at the time of negotiating transaction documents, which may indirectly reference mitigation measures as part of a CFIUS provision, and throughout the process of a CFIUS review.

It is also important to understand two practice points regarding mitigation measures:

- CFIUS will look to the ultimate foreign parent company to be a signatory on a mitigation agreement. This can create a practical issue because the ultimate parent's board and senior executives may not be tracking or aware of the details of the transaction, particularly in smaller transactions.

- Parties may not know what mitigation measures CFIUS will require until very late in the process. Although in our experience the committee staff makes every effort to communicate mitigation measures at least several weeks before the conclusion of an investigation period, exceptions exist when the need for mitigation measures does not become apparent until much later.

The CFIUS regulatory clock can be brutal, and differences in time zones, language barriers, and sign-off requirements for each successive turn of negotiated documents can significantly decrease the amount of time available for the parties to negotiate and evaluate mitigation measures.

Parties appearing before CFIUS should contemplate mitigation measures the committee could require, understand how those mitigation measures may undermine the realization of transaction objectives, and communicate with the ultimate parent about these issues early in the process.

4. Statistics on Withdrawals

Consistent with recent years, a significant number of parties withdrew their notices from CFIUS review in 2018, as demonstrated in the below table.

Year	Notices Reviewed	Notices Withdrawn	Withdrawn & Refiled	Withdrawn & Abandoned in Light of CFIUS National Security Concerns	Withdrawn & Abandoned – Other Reasons
2016	172	27	15	3	9
2017	237	74	44	24	6
2018	229	66	42	18	6

In practice, the most important data points for parties to follow with respect to withdrawals are (1) the number of notices withdrawn and abandoned in light of CFIUS national security concerns, and (2) the number of withdrawn notices subsequently refiled.

Parties should be mindful that between 2017 and 2018, at least 10% of notified transactions were abandoned in light of CFIUS national security concerns and related barriers.

Specifically, in 24 instances in 2017 and 18 instances in 2018, parties withdrew their notice and abandoned the transaction altogether because either CFIUS informed the parties it was unable to identify any mitigation measures that would resolve the committee's national security concerns with respect to the transaction, leaving the parties little choice but to

abandon the deal, or because CFIUS required mitigation measures as a condition to clearance that the parties chose not to accept. '

Required mitigation measures in those circumstances often include the divestiture of part or all of the U.S. business or other extreme measures that frustrate the underlying rationale or value of the transaction.

Parties accordingly should recognize that although the committee has referred only a handful of transactions to the president in recent years, CFIUS, through its robust reviews, effectively has prohibited many other transactions from closing without necessarily escalating the matters for presidential review.

Second, the number of notices withdrawn and refiled is one measure of how many parties experience extended regulatory hurdles to closing. Parties request approval from CFIUS to withdraw and refile their notice for a number of reasons, including to provide the parties more time to answer questions received from the committee, to address national security concerns identified by the committee, or to negotiate and reach an agreement on mitigation terms.

Absent a withdrawal, CFIUS remains bound by its regulatory clock with respect to the notice and generally must conclude action or refer the matter to the president within 90 days. When parties withdraw and refile their notice, the regulatory clock resets and affords the parties an opportunity to address necessary items without the urgent threat of rejection or referral of the transaction to the president.

Of course, such resetting also subjects the parties to new regulatory periods for CFIUS to review and, if necessary, investigate the transaction. Some refiled notices may need only a few additional days to finalize and execute a mitigation agreement. Other notices may face another 45-day review and 45-day investigation periods after being refiled, as the fact that a refiled notice already has been before the committee is no guarantee that CFIUS will complete its review or investigation early.

In any event, the general result is that parties who refile notices endure some degree of extended regulatory review before CFIUS clears the transaction. According to the 2018 annual report, at least 18% of transactions met this outcome in 2018.

5. Chinese investors continue to account for largest proportion of CFIUS filings, but investors from nearly any foreign state may be subject to mitigation.

Not surprisingly, with respect to notices filed from 2016 to 2018, Chinese investors accounted for the most notices filed each year and for 26.5% of the notices filed over that three year period — the largest proportion of notices attributable to any single country.

This data reflects practice trends in which parties to Chinese-origin transactions acknowledge an increasing likelihood that CFIUS will identify national security concerns with respect to the transaction and elect to voluntarily notify CFIUS of the transaction in order to mitigate those concerns before closing.

In practice, however, not all Chinese acquisitions raise national security concerns, nor are Chinese investors the only foreign parties who have been subject to mitigation requirements. In the last twelve months, for example, we have seen a Chinese company obtain control of U.S. businesses with no mitigation required while seemingly benign transactions, such a French corporation's acquisition of a small U.S. business, have been

subject to mitigation requirements.

Given that CFIUS is placing heightened scrutiny on the investor's third-party relationships, foreign parties from U.S.-friendly nations should not assume their investments are immune from raising national security risks.

Chinese investors also accounted for the largest proportion of notices reviewed in the manufacturing sector — 36.5% — and in the finance, information, and services sector — 22% — during that period.

Of the 76 transactions involving acquisitions of U.S. critical technology companies in 2018, eight originated from China, roughly equal to the number of such acquisitions originating from Japan (nine), Canada (nine), France (seven), and Germany (seven).

Aside from China, investors from Canada, Japan and France account for the next largest proportions of filings. Declarations from Canadian investors are expected to drop slightly beginning in 2020 as Canada has been identified as an eligible excepted foreign state under FIRRMA, which will result in the exception of certain Canadian-origin non-controlling investments from CFIUS review, provided a number of conditions are met.

Parties should note, however, that such exceptions require each parent of the foreign investor to be organized under and have its principal place of business in the excepted foreign state, among other criteria, meaning that a Chinese-owned Canadian company would not be considered an excepted foreign investor.

Michael J. Lowell is a partner, Sarah S. Wronsky is counsel, and Paula A. Salamoun and Courtney Fisher are associates, at Reed Smith LLP.

[1] https://www.reedsmith.com/en/perspectives/2020/01/final-cfius-regulations-set-stage-for-new-era-of-national-security-reviews.

[2] CFIUS does not appear to adjust its data to account for transactions that are the subject of more than one notice, i.e. transactions that are withdrawn and refiled as a new notice. As a result, the report data may underreport filing trends. The 2018 Annual Report identifies that CFIUS reviewed 229 notices in 2018 and that 34 notices were refiled in 2018. This suggests that CFIUS reviewed only 195 unique transactions in 2018, which heightens the impact of certain data points provided in the report. For example, the report's disclosure that parties adopted mitigation measures in 29 of the 229 notices in fact suggests that nearly 15% of the unique transactions reviewed by CFIUS in 2018 met mitigation barriers to closing — not the 12.6% that the report suggests on its surface. Accordingly, in light of these apparent adjustment gaps in the report, this article flags statistical percentages based on the report data as "at least" the amount denoted.