

# CFIUS's Annual Report to Congress Highlights Decrease in Investigations, Need for Transparency

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## Key Developments

The Committee on Foreign Investment in the United States (CFIUS) is an interagency organization charged with identifying potential national security risks posed by foreign acquisitions of U.S. businesses and mitigating those risks as necessary. If CFIUS determines that the national security risks cannot be mitigated adequately, it recommends that the U.S. president block the transaction. CFIUS's authority extends both to proposed transactions and to transactions that have already been completed.

On February 19, 2016, CFIUS issued the unclassified version of its annual report to Congress.<sup>1</sup> The report, which focuses on CFIUS activity during calendar year 2014, identifies key developments relating to the CFIUS process and important considerations for parties contemplating cross-border acquisitions of U.S. businesses.

During 2014, the number of transactions reviewed by CFIUS increased by more than 50 percent, reflecting the general upswing in merger and acquisition activity; CFIUS's case-load has returned to levels not seen since the 2008 financial crisis. However, the percentage of CFIUS cases requiring a second-stage investigation period dropped significantly in 2014, to 35 percent, and fewer transactions (in both absolute and percentage terms) required mitigation of national security risks. The percentage of transactions abandoned during the CFIUS process (*i.e.*, CFIUS notices were withdrawn and not refiled) appears to have remained fairly constant, at 7 percent. However, CFIUS also took the unprecedented step of noting its rejection of a notice after the CFIUS process had started.

China remained the source of more CFIUS cases than any other country, particularly if one includes the surge in CFIUS notices originating in Hong Kong; together, mainland China and Hong Kong accounted for 20 percent of CFIUS notices in 2014. However, there was a major resurgence in CFIUS notices from the United Kingdom, where 14 percent of CFIUS notices originated during 2014.

Finally, based on 2014 activity, the U.S. Intelligence Community (USIC) reiterated its belief that there may be a coordinated foreign strategy to acquire U.S. critical technology businesses, but apparently did not tie specific Chinese acquisitions in the semiconductor sector to the Chinese government's 2014 issuance of a national semiconductor industry policy and creation of investment funds supporting development in that sector.

## Fewer Investigations and Mitigations Reflect Swing of Geographic Pendulum

CFIUS cases begin with the filing of a notice describing the parties and the transaction. CFIUS then has 30 days to review the transaction, but can extend the process for an additional 45-day "investigation" stage if necessary. By default, transactions involving foreign government-controlled entities must undergo a second-stage investigation unless the requirement is waived by agreement of the deputy secretaries of the nine voting CFIUS agencies.

From 2009 (the first full year under current CFIUS rules) until 2012, the number of CFIUS cases requiring second-stage investigations has increased each year, but consistently hovered just below 40 percent of all cases. In 2013, the percentage of cases undergoing investigations spiked by 10 percent, though half of the increase was the

<sup>1</sup> Committee on Foreign Investment in the United States, Annual Report to Congress, Report Period: CY 2014, Public/Unclassified Version (February 2016), available at <https://www.treasury.gov/resource-center/international/foreign-investment/Documents/Annual%20Report%20to%20Congress%20for%20CY2014.pdf>.

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direct result of the October 2013 U.S. government shutdown. In 2014, however, the percentage of investigations dropped to the lowest level since the adoption of the current CFIUS rules:

Year	Cases	Investigations	%
2009	65	25	38%
2010	93	35	38%
2011	111	40	36%
2012	114	45	39%
2013	97	48	49%
2014	147	51	35%
Total	480	193	40%

In addition to fewer second-stage investigations, CFIUS reported fewer uses of mitigation measures. Mitigation was required in nine transactions during 2014, or 6 percent of the cases reviewed; by comparison, mitigation was required in 11 transactions, or 11 percent of transactions reviewed, in 2013.

The 2014 decline in second-stage investigations may reflect an improvement in internal CFIUS processes in response to the sharp increase in investigations during the previous year. However, the decline in both investigations and the use of mitigation measures may also reflect a disproportionate increase in CFIUS filings from countries traditionally viewed as less threatening to U.S. interests.

- As in recent years, China was the leading source of CFIUS notices, with 24, a modest increase from 21 notices in 2013. Even including the increase in filings by Hong Kong acquirers (6, up from 1 in 2013), the increase in filings from Greater China did not keep pace with the overall increase in CFIUS notices.
- The 50 percent increase in CFIUS notices during 2014 was driven by other countries, led by the United Kingdom, whose filings tripled in 2014 to 21. Other countries contributing to the increase in 2014 included Australia, Canada, Germany, Israel, the Netherlands, Singapore, South Korea and Switzerland (61 total filings in 2014, versus 25 in 2013).

## Cautionary Note: Rejection of a CFIUS Notice Highlights Need for Transparency

In this year's annual report, CFIUS included an unprecedented statement that one notice filed during 2014 "was rejected during the review or investigation." CFIUS is authorized to reject notices after the formal review process has started if (i) there is a material change in the transaction, (ii) CFIUS obtains information that contradicts material information provided by the parties, (iii) if the parties do not provide timely responses to follow-up questions from CFIUS, or (iv) if one of the parties is unwilling to certify the accuracy of all information submitted during the

course of the CFIUS process.<sup>2</sup> Rejection of a CFIUS notice for any of these reasons can be tantamount to blocking the transaction if CFIUS approval is a closing condition.

CFIUS's decision to report a rejected notice likely means that one of the parties to a transaction included a material misstatement or omission in the notice or was unwilling to respond to a request for supplemental information.<sup>3</sup> If a notice was rejected because a transaction changed, CFIUS also would likely have reported (as it does for withdrawn notices) that a new notice had been filed for the revised transaction. In addition, it is highly improbable that a party, after providing its initial certification and then completing a 30-to-75-day CFIUS process, would decline to provide a final certification.

The report that CFIUS rejected a notice in 2014 serves as a warning to parties that transparency is a critical element for success in the CFIUS process. CFIUS has access to a wide range of sources, including classified intelligence, with which information submitted by the parties can be verified. Failure to provide complete and accurate information in the CFIUS notice and in response to CFIUS's questions can undermine confidence in a party's trustworthiness and potentially reduce CFIUS's willingness to clear a transaction, even with mitigation. Moreover, allowing a discrepancy to remain unresolved can substantially reduce a party's prospects in future CFIUS reviews.

## Coordinated Strategy to Acquire US Critical Technology Companies

A required component of CFIUS's annual report to Congress is an evaluation of whether there is a coordinated strategy by one or more foreign countries or companies to acquire U.S. companies involved in research, development or production in "critical technologies for which the United States is a leading producer." This determination relies on analysis of a set of transactions principally involving export-controlled technologies; these transactions are often, but not always, reviewed as part of the normal CFIUS process.

Based on analysis of the transaction list for 2014, the USIC repeated its finding from 2013: It "believes there may be an effort among foreign governments or companies" to acquire U.S. critical technology companies. The USIC reached this conclusion, which is relatively noncommittal, despite the issuance in June 2014 of China's *Guidelines to Promote National Integrated Circuit Technology Development* and the establishment in 2014 of sizable Chinese national and provincial government investment funds focused on the semiconductor industry.

<sup>2</sup> 31 C.F.R. §800.403(a).

<sup>3</sup> CFIUS routinely provides reasonable extensions to the three-business-day deadline for responses to its follow-up questions, so failure to provide a timely response would generally reflect the relevant party's unwillingness to do so.

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In 2014, the Semiconductor and Other Electronic Manufacturing sector was the subject of more CFIUS reviews (12 notices, or 8 percent) than any other industrial sector,<sup>4</sup> and as discussed above, China was the leading source of CFIUS filings. Evidently, the Chinese transactions reviewed by CFIUS in 2014 did not involve “critical” (*i.e.*, export-controlled) semiconductor technologies or were not deemed to be a clear result of 2014’s initiatives by the Chinese government

Based on our experience, including our work on a number of semiconductor transactions that were completed or proposed in

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<sup>4</sup> Based on 4-digit NAICS codes.

2015, we would not be surprised to see a more definitive conclusion in next year’s annual report to Congress. We must stress, however, that findings with regard to a coordinated strategy do not affect CFIUS’s assessment of the national security risks associated with individual transactions.

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Continuing attention to these and other issues relating to CFIUS, along with thorough due diligence, advance planning and a proactive approach to the CFIUS process, will remain vital to the success of cross-border investments targeting U.S. businesses.

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