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Report from Washington

Key Takeaways from the CFIUS Annual Report to Congress Covering Calendar Years 2016 and 2017

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Introduction

On November 22, 2019, the Committee on Foreign Investment in the United States ("CFIUS" or the "Committee") released its Annual Report to Congress, which includes trends and data on the number and types of transactions reported to the Committee during the 2016 and 2017 calendar years, the most recent years for which this data has been made available. CFIUS is an inter-agency committee with the statutory mandate to review certain foreign investment into the United States for national security concerns. The data and trends included in the Report provide key insights into the Committee's review process. While the passage of the Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA") has made significant changes to CFIUS's jurisdiction and the CFIUS review process since the period covered by the report, the Committee's report still offers important insights and trends regarding the countries and industry sectors involved in transactions notified to CFIUS.

Continued Upward Trend in the Number of Notices Submitted to CFIUS

One clear trend from the data in CFIUS's report (the "Report") that is likely to accelerate with the implementation of FIRRMA is the increasing case load for CFIUS. The Committee reported 172 notices filed in 2016, which was a 20 percent increase over the 143 notices filed in 2015. The 237 notices filed in 2017 represented another 38 percent increase over the number filed in 2016. The number of notices filed in 2017 was the highest number reported since CFIUS began publishing annual reports in 2007. Every indication is that the number of notices and declarations submitted to CFIUS increased in 2018 and will significantly increase as a result of FIRRMA and the implementation of a mandatory filing requirement for certain transactions.

FIRRMA expanded the definition of "covered transaction" within the Committee's jurisdiction to include non-controlling "other investments" in U.S. businesses involving critical technologies, critical infrastructure, or sensitive personal data on U.S. citizens. Additionally, FIRRMA brought transactions involving real estate (but no U.S. business) in close physical proximity to sensitive U.S. government or military facilities and other locations within CFIUS's jurisdiction. CFIUS also implemented a Pilot Program in November 2018 to review both controlling and non-controlling investments by foreign persons in U.S. businesses involving critical technologies in

27 specified industries. Prior to the implementation of the Pilot Program, CFIUS filings were submitted pursuant to a voluntary filing regime. Transactions falling within the scope of the Pilot Program, however, must now be notified to the Committee either through a mandatory declaration or a formal notice. A declaration is an abbreviated version of a full formal notice, but CFIUS may request that parties submit a full notice if it cannot complete its review based on the limited information submitted in a declaration. It is expected that at least 235 notices and 110 declarations will be submitted by the end of 2019. The final FIRRMA regulations are still being finalized by the Committee, but promulgation of the final rules in February 2020 will undoubtedly further increase the case load of the Committee.

Significant Increase in the Percentage of Cases Going to Investigation in 2017 Compared to Historical Levels

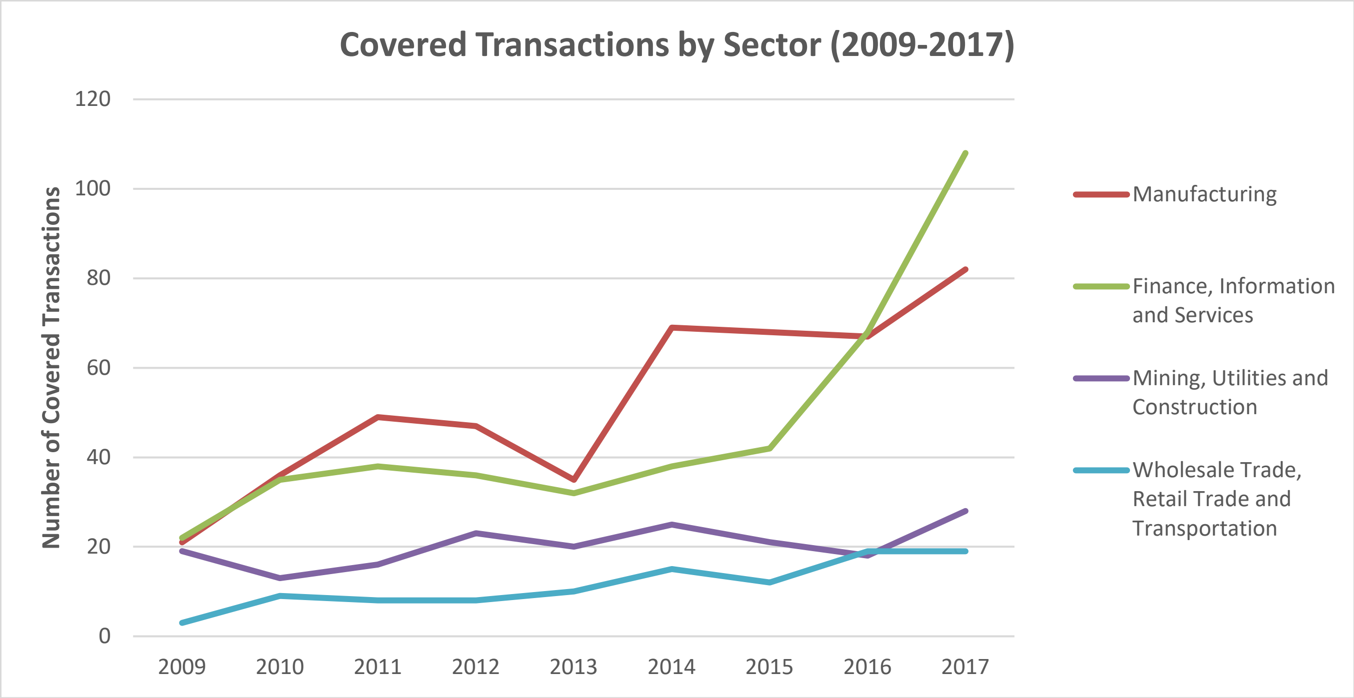
According to the Report, the total number of notices that were moved to the investigation stage increased in both 2016 and 2017. Prior to the implementation of FIRRMA, CFIUS was statutorily required to complete its initial review period within 30-days of the acceptance of the formal notice by the Committee. If the Committee was unable to rule out national security concerns and complete its review in this initial 30-day period, the notice would be moved to an additional 45-day investigation stage. The percentage increase in the number of such investigations remained flat between 2015 and 2016, holding steady at approximately 46 percent of the number of notices filed each year. That percentage increased dramatically in 2017, to almost 73 percent of notices being moved to the investigation stage. While the report does not explicitly explain this significant increase in the percentage of investigations, part of the impetus was likely the result of resource constraints arising from the sheer number of notices filed in 2017, a 38 percent increase over the number filed in 2016 and a 66 percent increase over the number filed in 2015. More notices were submitted to CFIUS in 2016 and 2017 than any other year since CFIUS started publishing annual reports in 2007. That said, the primary reason for the jump in investigations in 2017 was the geo-political environment in which cross-border transactions by investors from countries of special concern—China and Russia—received unprecedented scrutiny from the Committee. Based on publicly available data, a substantial majority of proposed acquisitions or investments by Chinese parties were effectively blocked and abandoned during 2017. Concern about transfer of advanced technologies to China was a major driver of the FIRRMA legislation enacted in 2018.

While helpful in understanding the CFIUS review process, the data on the number of notices going to investigation is dated for several reasons. As explained, FIRRMA expanded the Committee's jurisdiction and created mandatory filing requirements for certain transactions, which likely will result in more notices and mandatory declarations being submitted. However, FIRRMA also increased the initial review period from 30-days to 45-days, which gives the Committee's staff additional time to conclude their assessment within the initial review period. FIRRMA also allocated additional personnel and financial resources to the Committee to increase the size of its staff, which may alleviate some of the constraints that previously plagued the Committee. Beginning in early 2020, filing fees equal to the lesser of $300,000 or one percent of the value of the proposed transaction will be implemented.

Despite the increased volume for the Committee's staff, our experience is that there has been a significant decrease in the number of notices being moved to the investigation stage. Based on our information, we believe more than 50 percent of reported transactions are clearing in the initial review period, which is certainly a welcome development for users of the CFIUS process. We attribute this primality to the additional 15-days included in the initial review period pursuant to FIRRMA and the additional staff and resources, which will be further expanded in the years to come.

Industry Sectors

The Manufacturing sector and the Finance, Information, and Services sector continued to be the subject of the largest number of transactions notified to the Committee in 2016 and 2017. The Manufacturing sector and the Finance, Information, and Services sector combined made up more than 80 percent of the notified transactions in 2017. The Manufacturing sector includes semiconductor manufacturing, which historically has been a key focus of the Committee. According to the Report, the number of covered transactions in the Finance, Information, and Services sector made significant increases in 2016 and 2017 over prior years, increasing from 42 in 2015 to 68 in 2016, and 108 in 2017. We attribute this increase in part due to the fact that the Committee has been increasingly focused on information technology and "big data" in recent years. We expect the number of reported transactions in this industry sector to continue to increase as more U.S. businesses are swept under FIRRMA's expanded jurisdiction for businesses that maintain or collect sensitive personal data on U.S. citizens.



*Source: Committee on Foreign Investment in the United States: Annual Report to Congress for CY 2016 and CY 2017

Countries the Subject of Notices

According to the Report, transactions involving investors from China continued, at least in 2016 and 2017, to make up the largest proportion of notices submitted to CFIUS. Notices involving investors from Canada, China, and Japan made up almost half of all notices filed from 2015 to 2017. Transactions involving Chinese investors accounted for the most notices from 2015 to 2017, accounting for 29, 54, and 60, respectively. This accounts for more than 25 percent of all notices filed during this same time period. While the number of transactions involving Chinese investors steadily increased during this period, the number of transactions involving investors from close allies of the U.S. such as Canada, Australia and the U.K. have remained relatively consistent. Additionally, there were a total of 38 notices involving Chinese investors in critical technology companies from 2016 to 2017. This is more than double the number of notices involving critical technology from the next leading country (Japan at 18). From published reports, many of these Chinese transactions were effectively blocked by the Committee.

Whether this trend continues given CFIUS's expanded jurisdiction and enhanced scrutiny of critical technology companies under FIRRMA remains to be seen. By all accounts, Chinese M&A transactions in the United States are down in 2018 and 2019 in response to the scrutiny being paid to such deals and the overall tensions in the United States-China bilateral relationship.

CFIUS is also expected to publish a list of excepted foreign states that will likely be limited to close U.S. allies such as Australia, Canada, and the U.K. Subject to certain limitations, investors from such excepted foreign states may be excepted from the scope of the new jurisdictional authorities relating to critical technology companies under FIRRMA. These and other changes to the CFIUS review process could have a significant effect on these trends once the final FIRRMA regulations are published in February 2020.

Blocked Transactions

The President has the broad statutory authority to issue an order blocking or unwinding a transaction if it poses unresolved national security concerns. Although this authority is broad, and final, it is rarely used. As a practical matter, parties typically abandon transactions where CFIUS indicates that it will make a recommendation to the president to block a transaction. While rare, blocking transactions has become an increasingly popular national security stick for presidents in recent years. The Report includes two such transactions that were blocked by the president, one in 2016 by then President Obama, and one in 2017 by President Trump. The latter also blocked another transaction in 2018. Notably, every transaction that has been blocked by a president involved national security concerns related to China.

- On February 2, 1990, President Bush ordered the state-owned China National Aero-Technology Import & Export Corporation to divest Mamco Manufacturing Company, a Seattlebased company that manufactured aerospace parts;

- On September 28, 2012, President Obama ordered Ralls Corporation, a U.S. company owned by Chinese nationals, to divest its interests in four wind farm projects in Oregon located near restricted airspace;
- On December 2, 2016, President Obama blocked the sale of the U.S. assets of a German semiconductor manufacturer, Aixtron SE, to a Chinese investor, Fujian Grand Chip Investment Fund;
- On September 13, 2017, President Trump blocked the sale of Lattice Semiconductor to Canyon Bridge Capital Partners, a private equity firm managed by U.S. nationals but backed by funds from several Chinese state-owned entities; and
- On March 12, 2018, President Trump prohibited Broadcom, a semiconductor manufacturer co-headquartered in Singapore and the United States, from acquiring Qualcomm, a leading U.S. semiconductor and telecommunications equipment manufacturers. Although Broadcom is headquartered in Singapore, CFIUS expressed concerns that the transaction would hinder U.S. research and development in the telecommunications sector and ultimately benefit telecommunications companies based in China such as Huawei.

Conclusions

As with past annual reports, this data is helpful in recognizing certain investment trends and in shedding some light on CFIUS's otherwise opaque and confidential review process. The increase in the number of notices submitted to the Committee is likely to continue for the foreseeable future given the changes expected to take effect pursuant to FIRRMA. Some of those same changes, particularly the extension of the initial review period to 45-days and the budgetary authority to hire more staff already appear to have reduced the number of notices being sent to the investigation stage as compared to the 2016 and 2017 data included in the Report. The increase in the number of notices in the Finance, Information, and Services sector will likely continue due both to an increase in the importance of information technology and "big data" for U.S. businesses as well as the increasing scrutiny of such technology by CFIUS and other regulatory stakeholders. The Report provides some helpful insights when considering the CFIUS risk posed by any particular transaction, but the significant changes currently in process pursuant to FIRRMA make pre-transaction CFIUS risk assessments both more challenging and more important than ever.

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