

Report from Washington

Key Takeaways from CFIUS's Annual Report Covering the 2015 Calendar Year

September 21, 2017

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On September 19, 2017, the Committee on Foreign Investment in the United States (CFIUS), the inter-agency committee charged with reviewing foreign investments in U.S. businesses for potential national security implications, released its Annual Report to Congress detailing the Committee's activity during calendar year 2015. The report offers an overview of the deals that came before the Committee during 2015 and provides insight into trends and touchpoints that may be helpful for parties to consider in making cross-border investments into the United States. While informative, the usefulness of the 2015 data is significantly tempered by its age (the Annual Report was released 21 months after the close of the 2015 calendar year). The political and regulatory environment affecting foreign trade and direct investment has shifted dramatically since 2015, particularly in relation to proposed investments by Chinese investors in U.S. businesses. Thus, while the release of the 2015 data is welcome, it does not provide a reliable basis to project CFIUS outcomes in the near to medium term.

The Number of Notices Deemed Covered Transactions in 2015 Was Similar to 2014

The annual number of CFIUS notices deemed covered transactions increased year over year from the end of the financial recession in 2009 through 2012, increasing from 65 filings to 114. That trend ended in 2013 when just 97 notices were reviewed during the year. 2013 proved to be an aberration, however, as 2014 saw a significant jump with 147 notices determined to be covered transaction by the Committee. The 2015 total of 143 notices is down slightly from 2014, and just shy of the record high of 155 notices reviewed in 2008. But all indications are that the general upward trend in CFIUS activity has continued through 2016 and into 2017. By all reports, CFIUS is on track to review more than 200 cases in 2017, with resulting resource constraint challenges. If the 2017 data were released today, there

would be a decided trend of parties increasingly pulling and re-filing CFIUS notices, and not only once but twice.

Covered Transactions Involving East Asian Buyers Continue to Outpace the Rest of the World

2012 was the first year in which the number of reviewed transactions involving Chinese investors exceeded the individual total of any other country. The latest report confirms that trend continues. In 2015, the number of covered transactions involving mainland Chinese investors increased to a new all-time high of 29, topping the previous high of 24 set the year before. Hong Kong had two cases bringing the total for China to 31. We believe this upward trend continued in 2016 and 2017 (to date). Overall, between 2013 and 2015, investors from China and Hong Kong were involved in 83 covered transactions, or 34 transactions more than the next highest country (Canada) over the same period.

Following behind China, Japanese investors were involved in 12 covered transactions in 2015, Singapore investors another three, and investors from South Korea were involved in one covered transaction during the year. While the number of covered transactions involving Japanese investors was up from 2014, the number of transactions involving investors based in Singapore and South Korea all decreased in 2015.

The Number of Filings That Entered the Investigation Stage Increased Considerably

In 2015, CFIUS opened investigations in 66 of the 143 instances of notified transactions, which sets a new confirmed all-time high—topping the previous record of 51 investigations conducted in calendar year 2014. As a percentage, CFIUS investigated approximately 46% of notified transactions in 2015.

From 2009 to 2012, the number of covered transactions proceeding from the initial 30-day review period to the 45-day investigation stage rose steadily, but the percentage of covered transactions investigated by CFIUS consistently fell within a few points of 38%. In 2013, 48 of the 97 covered transactions—or approximately 49%—entered the investigation stage. While the absolute number of investigations entering the investigation stage in 2014 increased by three to reach 51, the percentage of investigated transactions reverted back to the historical norm.

Viewed historically, the 66 investigations opened by CFIUS in 2015 represent a considerable increase in both number and percentage of covered transactions that entered the investigation stage.

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The Number of Notices Withdrawn During the Investigation Phase Remained Constant

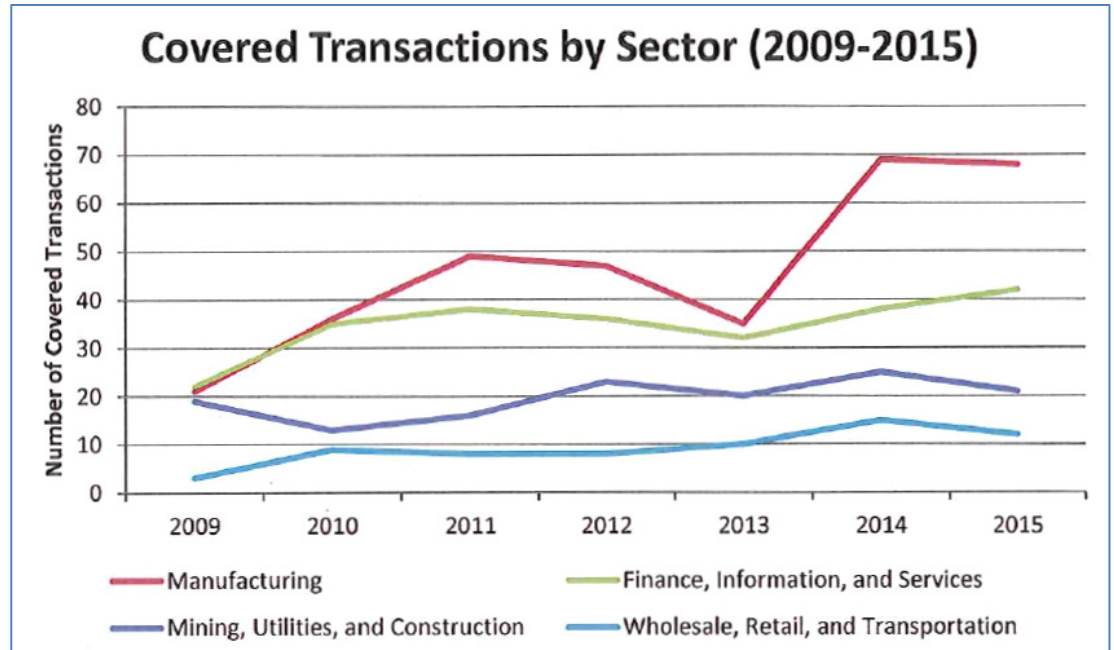
Notwithstanding the uptick in investigated covered transactions, only ten of the 66 investigations resulted in withdrawn notices, or about 15%. This number is consistent with 2014, when nine investigated notices were withdrawn, but lower when viewed as a percentage—approximately 18% of investigated notices were withdrawn in 2014. And both are considerably lower than in 2012 when 20 notices (approximately 44%) were voluntarily withdrawn after CFIUS opened an investigation. That said, while CFIUS has not released figures for 2016 or 2017 year to date, we anticipate that the pace of withdrawals has increased significantly from 2015.

As in previous years, the latest Annual Report does not disclose the transaction-specific circumstances of withdrawals, but does acknowledge that some notices were withdrawn and refiled with approval of CFIUS to allow the Committee more time to consider national security concerns. Other notices were withdrawn and never refiled because the underlying transactions were abandoned either entirely or at least with respect to the involvement of the foreign party that prompted the notice.

Providing greater detail than in past years, the latest Annual Report specifically notes that the parties to three covered transactions withdrew their notices after CFIUS informed them that the Committee was unable to identify mitigation measures that would resolve its national security concerns or the Committee proposed mitigation terms that the parties chose not to accept. This will be a useful data point going forward should CFIUS continue to specify how many notices were withdrawn due to unresolved national security concerns. These are effective “blocks” by the Committee short of needing to go to the President to issue an order formally prohibiting a transaction.

Manufacturers Continue to Be the Most Frequent Targets in Covered Transactions

Each year, the Annual Report categorizes the sector of the U.S. target as either manufacturing; finance, information, and services; mining, utilities, and construction; or wholesale, retail, and transportation. In 2015, 68 of 143, or approximately 48%, of notices involved targets that were categorized as manufacturers. This is up from 47% in 2014, and 36% in 2013.



*Source: [Committee on Foreign Investment in the United States Annual Report to Congress for CY 2015](#) (2017)

“Computer and Electronic Product Manufacturing continued to represent the largest share of the manufacturer sector targets, accounting for 49% of all covered transactions that involved manufacturing in 2015.”

Computer and Electronic Product Manufacturing continued to represent the largest share of the manufacturer sector targets, accounting for 49% of all covered transactions that involved manufacturing in 2015. Notably, 18 covered transactions involved Semiconductor and Other Electronic Component Manufacturing, which accounted for more than half of the covered transactions in the Computer and Electronic Product Manufacturing subsector. Other significant manufacturing subsectors were Chemical, Machinery, and Transportation Equipment Manufacturing—each with eight notices. Of these three manufacturing subsectors, Chemical Manufacturing represented the largest increase in manufacturing-related notices over the prior year, increasing from 9% in 2014 to 12% in 2015.

Additional Sensitivities Added to List of Perceived Adverse Effects Considerations

To the extent possible, CFIUS is required to discuss the considerations used to evaluate the perceived adverse effects of covered transactions on United States national security or critical infrastructure. Traditionally, CFIUS includes a section in its Annual Report that provides a non-exhaustive list of considerations. This year, CFIUS has included foreign control of U.S. businesses that:

- Are in a field with significant national security implications in which there are few alternative suppliers or in which a loss in U.S. technological competitiveness would be detrimental to national security
- Hold substantial pools of potentially sensitive data about U.S. persons and businesses that have national security importance. Such businesses could be in any number of sectors, including, for example, the insurance sectors, health services, and technology services

This year's Annual Report also expands on the types of advanced technologies that the Committee considers, specifically noting that past transactions have included businesses that:

- Design, produce, or provide goods and services involving network and data security
- Produce semiconductor manufacturing equipment, design integrated circuits, and fabricate integrated circuits, in light of the fact that semiconductors are an enabling technology for a range of national security critical devices, systems, and functions
- Are in the biotechnology sector, given the potential military applications of such technology and the sensitivity of the information such companies may collect

Lastly, CFIUS expanded its list of considerations to include acquisition of control by foreign persons that have a history of doing business in sanctioned countries.

The Committee Continues to Request Mitigation Measures to Address National Security Concerns

In 2015, 11 transactions were approved only after the Committee negotiated legally binding mitigation measures, which is up from 9 in 2014. Although this year's Annual Report does not identify the industries of the transactions that involved mitigation measures, it does describe the mitigation measures negotiated and adopted. Those measures included:

- Ensuring that only authorized persons have access to certain technology and U.S. Government, company, or customer information, and that the foreign acquirer not have direct or remote access to systems that hold such information
- Establishing a Corporate Security Committee and other mechanisms to ensure compliance with all required actions, including the appointment of a U.S. Government-approved member of the board of directors
- Establishing guidelines and terms for handling existing or future U.S. Government contracts, U.S. Government customer information, and other sensitive information
- Ensuring that only U.S. citizens handle certain products and services, and ensuring that certain activities and products are located only in the United States
- Notifying security officers or relevant U.S. Government parties in advance of foreign national visits to the U.S. business for approval

- Security protocols to ensure the integrity of goods or software sold to the U.S. Government
- Notifying customers of the change of ownership
- Assurances of continuity of supply for defined periods, and notification and consultation prior to taking certain business decisions, with certain rights in the event that the company decides to exit a business line and established meetings to discuss business plans that might affect U.S. Government supply or national security considerations
- Exclusion of certain sensitive assets from the transaction
- Providing relevant U.S. Government parties with the right to review certain business decisions and object if they raise national security concerns

The U.S. Intelligence Community’s Conclusion of a Coordinated Foreign Strategy to Acquire Critical Technology Companies is Not Provided

In last year’s Annual Report, CFIUS restated the conclusion of the U.S. Intelligence Community that there may be an effort among foreign governments or companies to acquire U.S. companies involved in research, development, or production of critical technologies for which the United States is a leading producer. This year’s Annual Report, however, states only that “[a] meaningful summary of the U.S. Intelligence Community (USIC) assessment cannot be provided on an unclassified basis.” Although no conclusion is provided, all indications—including anecdotal experience—suggest this issue remains a significant concern to the U.S. Intelligence Community. Indeed, this year’s Annual Report reaffirms that “foreign governments are extremely likely to use a range of collection methods to obtain critical U.S. technologies.”

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While the transparency of the CFIUS review process is inherently limited, the 2015 data reflect that the Committee continued to clear most of the transactions it reviewed. That said, the data showing an increased number of transactions subject to investigations, along with the increased number of withdrawn or mitigated notices, are consistent with trends seen by CFIUS practitioners and that have surged upwards over the past two years. The current environment has never been more challenging, particularly for proposed investments by Chinese firms, and requires that parties to transactions with a nexus to U.S. national security conduct a pre-transaction CFIUS risk analysis.

To learn more about the CFIUS process and how to navigate it effectively, please contact any of the following:

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