

E-ALERT | International Trade

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CFIUS 2011 ANNUAL REPORT TO CONGRESS

The Committee on Foreign Investment in the United States (“CFIUS”) recently released its [Annual Report to Congress](#) on transactions filed in 2011. The report provides data on all notices filed with CFIUS during the 2011 calendar year and all reviews or investigations completed during that year. The report also includes key findings with respect to acquisitions of U.S. critical technologies as well as other issues concerning foreign direct investment in the United States. While the report indicates that the United States remains open to foreign investment and CFIUS’s record of clearing transactions remains positive, the report reveals certain challenges in CFIUS’s assessment of and approach to transactions involving critical technologies and other national security-related factors. These challenges have been most acute with respect to covered transactions from China.

NOTEWORTHY DIFFERENCES FROM PRIOR ANNUAL REPORT

While much of the information in the most recent report is consistent with the trends that we have observed and have reported to you previously, there are several notable differences from the immediate past report relating to the 2010 calendar year.

CHANGE IN INTELLIGENCE COMMUNITY’S ASSESSMENT OF A COORDINATED STRATEGY AMONG FOREIGN ACQUIRERS TARGETING U.S. CRITICAL TECHNOLOGIES

Perhaps the most salient difference in the report is the change in the U.S. intelligence community’s assessment of whether there is a coordinated strategy by one or more foreign governments or companies targeting U.S. critical technologies through M&A transactions. According to the report, the intelligence community believes with “moderate confidence” that there is likely a coordinated strategy among foreign governments or companies to acquire U.S. “critical technology” companies — a circumstance that was found to be “unlikely” in prior reports. This assessment reflects input from a broad cross-section of the U.S. intelligence community drawing upon various areas of expertise.

The term “critical technologies” is defined in CFIUS regulations to mean:

- Defense articles or defense services covered by the United States Munitions List of the International Traffic in Arms Regulations administered by the State Department;
- Those items specified on the Commerce Control List of the Export Administration Regulations administered by the Commerce Department that are controlled pursuant to multilateral regimes (i.e., for reasons of national security, chemical and biological weapons

proliferation, nuclear nonproliferation, or missile technology), as well as those that are controlled for reasons of regional stability or surreptitious listening;

- Specially designed and prepared nuclear equipment, parts and components, materials, software, and technology specified in the Assistance to Foreign Atomic Energy Activities regulations of the Department of Energy, and nuclear facilities, equipment, and material specified in the Export and Import of Nuclear Equipment and Material regulations of the Nuclear Regulatory Commission; and
- Select agents and toxins specified in the Select Agents and Toxins regulations of the Department of Agriculture and the Department of Health and Human Services.

In our experience, while the current report covers the 2011 period, the change in the intelligence community's assessment that foreign governments and companies are, in a concerted effort, specifically targeting the acquisition of critical technologies also reflects a very current view that has animated CFIUS action in 2012. Moreover, similar to the report covering 2010, the intelligence community also finds in the most recent report that foreign governments are "extremely likely" to continue to use a range of collection methods to obtain commercial secrets related to critical technologies.

EXPANSION OF FACTORS CFIUS EVALUATES TO DETERMINE WHETHER TRANSACTIONS WOULD ADVERSELY AFFECT NATIONAL SECURITY

Each year, the CFIUS annual report includes the list of national security considerations that CFIUS evaluates to determine whether a transaction would adversely affect national security and pose a national security risk. Importantly, the most recent report now adds "proximity to certain types of [U.S. government] facilities" as a factor that CFIUS evaluates. We [previously have reported](#) that proximity to U.S. military bases and other sensitive facilities can present concerns, especially in cases involving China. There have been several cases in recent years in which proximity issues have presented irreconcilable national security risks.

Other factors on the list have been expanded. The reference to businesses in the energy sector that can implicate national security has been clarified and expanded to include "businesses that involve various aspects of energy production, including extraction, generation, transmission, and distribution." CFIUS considers whether these businesses, and others, have operations, or produce or supply products or services, the security of which may have implications for U.S. national security.

In addition to businesses that have access to classified information, the list of factors that CFIUS considers now includes businesses that have access to "sensitive government or government contract information, including information about employees." Finally, the list now includes businesses involved in satellite activities.

INCREASING NUMBER OF CHINESE TRANSACTIONS

The most recent report also explicitly notes that the number of notices filed by Chinese acquirers is growing each year. Investors from China accounted for ten transactions, representing nine percent of transactions, filed with CFIUS in 2011. This compares with six transactions filed in 2010 and just four in 2009.

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While these differences appear in the report covering 2011, they also shed light on certain tensions underlying transactions filed in 2012 as well. These tensions often are in sharpest relief in connection with CFIUS's review of transactions involving Chinese acquirers. The United States remains officially open to Chinese investment — indeed, President Obama and senior administration officials affirmed this throughout 2011 and Assistant Secretary of Treasury Marisa Lago made this clear again when she spoke in Beijing in November 2012. However, trends including those highlighted in the most recent CFIUS report and that we have previously noted — including concerns raised by proximity and difficulties in “non-notified” transactions that have closed — are presenting challenges in transactions involving Chinese acquirers. The intelligence community's assessment with respect to a coordinated strategy for acquiring critical technologies adds a layer of complexity that is acute in these transactions.

OTHER HIGHLIGHTS FROM THE MOST RECENT REPORT

- The number of cases that proceeded to the investigation stage remains relatively high. Of the 111 notices filed in 2011, CFIUS conducted a second-stage investigation — in addition to the initial 30-day review — in 40 cases. This represents 36 percent of the transactions reviewed by CFIUS during the covered year and is nearly identical to the percentage of cases that proceeded to the investigation stage in 2010 and 2009 (38 percent), but remains considerably higher than the levels from 2008 (only 15 percent) and 2007 (only four percent).
- In 2011, there were fewer withdrawals of cases before CFIUS, with a total of six cases withdrawn. One case was withdrawn during the initial 30-day review and five were withdrawn during the investigation stage. All six of these cases were re-filed in 2011 or 2012.
- CFIUS agencies negotiated, and parties adopted, mitigation measures in eight different covered transactions in 2011. This nearly matches the number of covered transactions that resulted in mitigation measures in 2010 but is slightly lower in terms of the percentage of all notified transactions. The mitigation measures entered into in 2011 involved acquisitions of U.S. companies in the software, computer programming, computer and electronic manufacturing, electrical equipment and component manufacturing, aerospace manufacturing, and finance sectors.
- Close allies of the United States — namely the United Kingdom, Canada, Japan and Australia — accounted for approximately 41 percent of all cases in 2011, slightly lower than in 2010. Consistent with prior years, acquisitions by investors from the United Kingdom were the largest: 25 transactions, and one transaction involving the United Kingdom and Germany. There were 9 transactions involving investors from Canada, 7 from Japan, and 4 from Australia.
- While transactions involving Chinese acquirers are growing each year, other major emerging economies have not kept pace. For instance, there were no transactions by Russian investors in 2011 in comparison with four transactions in 2010 and Brazil went from zero transactions in 2010 to one transaction in 2011.

- Transactions involving acquirers from France, Israel and India — countries with which the United States has strong relations and mutual interests but which can present challenging cases for CFIUS — remained constant or grew in number. Transactions involving French investors more than doubled in number with 14 notices filed in 2011. The six acquisitions filed by Israeli investors virtually tied the seven filed in 2010, and for the second year in a row, only one transaction involving an Indian acquirer was filed.
- There were no CFIUS notices filed by any member state of the Gulf Cooperation Council (“GCC”). However, the report notes that there were 11 M&A transactions involving GCC investors, namely from the United Arab Emirates, Saudi Arabia, Oman and Kuwait.
- The percentage of transactions on a sector-by-sector basis in 2011 was similar to 2010. The manufacturing sector accounted for slightly less than half of the notices filed in 2011 and a third of the 2011 notices were in the finance, information, and services sector. These two sectors account for 78 percent of all notices filed with CFIUS during the covered year.

The most recent report reaffirms that the United States remains open to foreign investment and that CFIUS is pre-disposed to approve transactions. At the same time, while the report does not signal a material change in the manner or substance of CFIUS reviews, it does suggest a tougher stance that is particularly manifested in transactions involving Chinese acquirers. The year 2012 has seen several cases exemplifying this stance, including the [wind farm case](#) that we reported on recently. We will continue to monitor developments in this field and will keep you apprised of information that may impact the timing and approval process for M&A transactions.

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