

## **Newly-Released CFIUS Annual Report for 2015 Foreshadows Heightened Scrutiny of Foreign Investment**

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CFIUS

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The Committee on Foreign Investment in the United States (“CFIUS”) this week released its long-awaited [Annual Report to Congress](#) regarding foreign acquisitions of U.S. businesses reviewed by CFIUS in 2015.<sup>1</sup> The report provides important data that yields insights into the types of transactions the Committee reviewed and the Committee’s treatment of those transactions. Among those insights are, we believe, indications that CFIUS in 2015 perceived a growing risk environment presented by foreign direct investment — a perception that appears to have accelerated more recently, particularly with respect to Chinese investment.

At the same time, it is important to note that this report captures data from 2015, and therefore reflects the Committee’s operations two years ago, during the prior Presidential administration. Since that time, we have seen significant changes in the role and conduct of CFIUS — changes that of course are not reflected in the 2015 data. Before turning to our analysis of the 2015 report, it therefore is appropriate to reflect for a moment on how CFIUS is operating today.

Most notably, the composition of foreign investment in the United States has shifted dramatically since the period covered by the report. In the three-year period from 2013 to 2015, CFIUS reviewed a total of 74 transactions involving Chinese acquirers. By contrast, we believe that CFIUS reviewed at least that many Chinese transactions in 2016 alone, out of a total of approximately 180 transactions, its highest-ever volume in a single year. And, as of this week, CFIUS already has recorded more than 175 cases to date for 2017, putting the Committee on a clear trajectory to yet another all-time record. We expect at least a similar number of Chinese transactions (i.e., more than 70) to be reviewed this year by the Committee, even as the aggregate number of all transactions considered by CFIUS also has grown materially.

It is in this context that we have seen an evolution in the orientation of CFIUS in 2016 and 2017, following the period covered by this week’s report, with that evolution becoming more pronounced with the transition this year to the administration of President Donald Trump. The resulting environment for transactions involving Chinese acquirers now is extremely challenging. For a variety of reasons — including, but not limited to, a number of key vacancies in senior-level policy positions throughout the CFIUS agencies; the lack of clear policy direction in support of finding solutions in support of Chinese investment; a deepening concern over Chinese industrial policy and what U.S. national security officials have described as China’s “weaponization” of business

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<sup>1</sup> CFIUS releases its annual reports on a delayed basis. The last such annual report, relating to 2014, was issued in February 2016.

to procure technologies that will advance its own capabilities; an increased volume of transactions; and the prospect of Congressional legislation directed at expanding CFIUS's review authorities to cover certain types of technology collaborations and transfers — CFIUS has become extremely risk adverse and exceedingly wary of Chinese investment in certain sectors at the moment, including in particular in the semiconductor industry. Consequently, transactions with Chinese parties that previously would have presented some concerns but that could be readily resolved through mitigation with CFIUS now are being effectively prohibited rather than mitigated. Indeed, even transactions that should present no meaningful national security concerns are being subjected to intense scrutiny and may face considerable delays. Notably, these same attributes increasingly apply to certain non-Chinese transactions as well, although not with the same frequency.

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Notwithstanding those more recent developments, the 2015 Annual Report offers an opportunity to take note of several characteristics and trends at that time in the CFIUS process:

- First, with the exceptions noted below, the 2015 Annual Report demonstrates remarkable consistency with the 2014 Annual Report. In 2015, CFIUS reviewed 143 notices — virtually identical to the 147 notices it considered in 2014. Despite a slight increase in the number of Chinese transactions reviewed by CFIUS in 2015 by comparison to 2014, the percentage of all transactions featuring a Chinese buyer remained relatively steady at between 16 and 20 percent over 2014 and 2015, respectively.
- Second, a notable difference from 2014 is the material rise in the number of investigations that CFIUS conducted, from a total of 51 in 2014 to a total of 66 in 2015, an increase of about 30 percent. Because most other metrics remained relatively constant, this increase cannot be explained by the growth in Chinese investment alone, given that the ratio of Chinese notices to total notices reviewed remained largely consistent from 2014 to 2015. Rather, the increased number of investigations likely reflects CFIUS' heightened scrutiny of transactions in what it perceived as a growing risk environment.
- Third, and finally, the notion that CFIUS apparently perceived (at least in 2015) an environment of increased risk may also be supported by the remarkable fact that, for the first time since 2009, the Annual Report declines to offer a view as to whether there is credible evidence of a coordinated strategy by foreign countries or companies to acquire U.S. companies involved in research, development, or production of critical technologies. Rather, the report states that the U.S. Intelligence Community ("IC") indicated that "a meaningful summary of its assessment" in this regard could not be provided on an

unclassified basis. While we are unable to determine definitively the precise reasons for omitting the IC's assessment from the public unclassified version of the report, this is further suggestive of a growing unease within both CFIUS and the IC over acquisitions of critical technology companies.

Taken together, we believe these trends suggest that 2015 marked the beginning of a perception within CFIUS of an increased risk environment presented by foreign investment, and especially Chinese investment. In turn, those somewhat subtle trends seen in the 2015 Annual Report foreshadowed the more significant changes that have since followed in 2016 and 2017.

The 2015 Annual Report further reinforces the lesson that parties seeking approval from CFIUS must now, more than ever, work with experienced CFIUS counsel proactively to identify and solve the government's potential national security concerns. We continue to observe, however, that sound commercial transactions with transparent parties and careful planning almost uniformly have continued to be successful before CFIUS.

## Other CFIUS Report Highlights

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- For the fourth year in a row, Chinese acquirers filed the greatest number of notices subject to CFIUS jurisdiction. Of the 143 notices that CFIUS reviewed in 2015, a total of 29, or 20.2 percent, were from China. This modest increase in the proportion of total notices attributed to Chinese acquisitions in 2015 is consistent with recent years — 24 notices in 2014, or 16.3 percent of the total, 21 notices in 2013, or 21.6 percent of the total, and 23 notices in 2012, or 20.2 percent of the total.
  - As noted below, we are confident that this proportion drastically increased in 2016, and likely in 2017 as well.
  - The overall volume of Chinese acquisitions and deals involving sensitive technological “know-how” and other perceived national security risks unquestionably continue to dominate the CFIUS agenda.
- Thus, looking back at the four-year period from 2012 to 2015, Chinese transactions represented 19 percent of all deals reviewed by CFIUS, more than 6 percentage points greater than Canada, the next largest home to filers. The United Kingdom and Japan occupied third and fourth place, respectively, in 2015, and similarly held top positions in the prior three years.
- The total number of CFIUS notices in 2015 remained fairly consistent to the number of notices in 2014, with 147 in 2014 and 143 in 2015.
  - We expect, however, that data in the eventually forthcoming 2016 and 2017 Annual Reports will highlight greater investment from emerging markets, especially China.
  - By our estimates, CFIUS reviewed approximately 80 to 90 Chinese transactions out of roughly 180 total transactions in 2016. As of this week, CFIUS already recorded more than 175 total cases for 2017 — an all-time record. Although the pace of Chinese investments seems to have eased somewhat, the overall number remains high.
- As in prior years, the largest concentration of acquisitions was in the manufacturing sector. Across all manufacturing subsectors, the largest numbers of acquisitions were in the following: computer and electronic products (33 notices); chemical (8 notices); machinery (8 notices); and transportation equipment (8 notices).

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- CFIUS rejected one notice in 2015 pursuant to 31 C.F.R. § 403(a)(2)(ii) because information available to the U.S. government contradicted information provided in the notice submitted by the parties. As a result of the rejection, CFIUS did not complete its review of the transaction. The parties subsequently abandoned the transaction.

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We hope that you find this analysis useful. Please do not hesitate to contact the following members of our CFIUS Practice Group if you would like to discuss any aspect of the foregoing in further detail:

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