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CFIUS Annual Report Shows Uptick in Foreign Direct Investment and a Decline in Mitigation

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On February 19, 2016, the Committee on Foreign Investment in the United States (CFIUS), which conducts national security reviews of foreign direct investment (FDI) into the United States, published its annual report summarizing the transactions it reviewed during 2014 (the Annual Report), which is the most recent calendar year for which data has been compiled. The **Annual Report** shows that 2014 was a positive year for FDI into the United States, with a marked increase in the number of transactions notified to CFIUS, a decline in the percentage of cases taken to a 45-day investigation, and a notable reduction in the percentage of cases for which CFIUS imposed mitigation measures. For the third consecutive year, China led all countries represented in CFIUS reviews, while European investors resurged following a decrease in activity during 2013.

The White & Case National Security and CFIUS practice typically participates in at least 10% of all transactions notified to CFIUS annually and evaluates many other deals to advise clients regarding potential CFIUS issues. Based on that experience, we offer the following comments and observations on the Annual Report:

- 2014 saw the highest number of notified transactions since the CFIUS regulations were substantially overhauled in November 2008. CFIUS reviewed 147 transactions in 2014, which was a 52% increase over the number of notified transactions in 2013 and a 33% increase over 2012. Although statistics for 2015 have not been published, we observed a comparable level of notified transactions in 2015.

- Despite the increase in volume, there was a substantial decline in the number of transactions that required an additional 45-day investigation. CFIUS's efforts to resolve more cases during the initial 30-day review period showed positive results, as only 35% of cases went to investigation in 2014—a record low percentage since the regulatory overhaul in 2008. Based on our experience, this may have been due in part to CFIUS utilizing the prefiling period more proactively to address questions prior to the start of the formal review period. Notwithstanding the decrease in investigations, we have observed that complex transactions—as well as those involving foreign government control or critical infrastructure or technologies—still typically require an investigation. In any case, since more than a third of cases move to investigation, it is wise to allow for a full 75-day process when planning deals.

- For the third consecutive reported year, China led foreign countries represented in CFIUS reviews in 2014. Chinese investors had 24 transactions reviewed in 2014, which was an increase from 21 in 2013.

Although the number of Chinese deals increased, the percentage of Chinese deals compared with all other countries declined due to the surge in the overall number of reviewed transactions.

- European investors made a strong showing in 2014 following a relative lull in 2013. In particular, the United Kingdom accounted for the second-most notified transactions—21—up from seven in 2013. Germany, the Netherlands, and Switzerland also increased their notified transactions significantly from 2013. Conversely, Japan, which had surged in 2013 with 18 notified transactions (second most for that year), fell to the fourth-most represented country in 2014 with 10 notified transactions. Canadian investors remained well represented with 15 notified transactions, the third most for 2014.

- 2014 showed a marked decline in transactions requiring mitigation measures. Only 6% of cases—down from 11% in 2013—involved mitigation. This was the lowest percentage under the new regulations and below the 2009-2014 average of 8%. Notably, the types of transactions requiring mitigation in 2014 narrowed to only those involving US target companies in the software, services, and technology industries. This focus is consistent with our experience with CFIUS in recent years, which has generally shown particular sensitivity regarding transactions involving cyber security and other technology issues. The Annual Report indicated no change in the types of mitigation measures CFIUS imposes.

- The Annual Report states that 12 of 147 filings were withdrawn in 2014, noting that one withdrawn transaction was refiled in 2015. This suggests that 11 transactions were abandoned, which is on par with previous years. Parties may abandon a transaction for several reasons, including because they are unwilling to accept proposed CFIUS mitigation measures, they learn that CFIUS intends to recommend that the President block the transaction, or they determine not to proceed for commercial reasons.

- While the Annual Report does not state which transactions resulted in investigations or mitigation, Chinese investors may find encouragement since despite an increase in both total transactions and Chinese investments reviewed, the number and percentage of deals requiring CFIUS-based mitigation declined. Moreover, there was no increase in abandoned transactions. Although it remains to be seen whether these trends have continued, and 2015 saw some notable Chinese transactions abandoned due at least in part to CFIUS concerns, the 2014 data shows positive signs for Chinese investors.

- The manufacturing sector experienced a significant uptick as the dominant target sector for FDI in 2014. Of the four broad sectors that CFIUS tracks—(1) manufacturing; (2) finance, information, and services; (3) mining, utilities, and construction; and (4) wholesale, retail, and transportation—manufacturing typically accounts for the most notified transactions. This was again true in 2014, but the percentage of notified transactions in the manufacturing sector jumped from 36% to 47%, while the trends in the other three sectors remained relatively flat or showed a decline.

- Consistent with the finding in CFIUS's annual report covering 2013, the Annual Report states that the US Intelligence Community (USIC) believes there *may be* efforts among one or more foreign governments or companies to acquire US companies involved in research, development, or production of certain critical technologies. In the annual report covering 2012, CFIUS reported that the USIC judged it *unlikely* that that there was such a coordinated strategy. Consistent with the previous annual reports, however, the Annual Report repeats its more general assessment that "the USIC judges that foreign governments are extremely likely to continue to use a range of collection methods to obtain critical U.S. technologies." The latter conclusion is consistent with news accounts of cyber-attacks on US companies, and CFIUS's focus on transactions involving cyber security issues and sensitive technologies.

Foreign investors looking to invest in US businesses should be generally encouraged by the Annual Report, which reflects a more efficient CFIUS process handling a record number of cases with relatively fewer investigations and mitigation requirements. It is important, however, to recognize the limitations of these statistics: they are over one year old and shed little light on important issues such as investigations and mitigation as a function of investor country, target business, or a combination of those factors. As CFIUS review can be a critical aspect of FDI into businesses with a nexus to US national security, and the concept of national security is interpreted broadly, careful transaction- and CFIUS-strategy planning can protect investors and help yield the greatest chances for success in the US market.

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