

CFIUS: Recent Developments and Trends

February 2017

Authors: Farhad Jalinous, Karalyn Mildorf, Keith Schomig, Norman Pashoian, Cristina Brayton-Lewis, Emily Wang

The past year has ushered in significant transformations in the cross-border M&A and US political landscapes, including a number of emerging developments and trends that have affected the review process of the Committee on Foreign Investment in the United States (CFIUS).

The CFIUS process has become increasingly relevant as the number of CFIUS reviews reached record numbers in 2016 and 2017 is off to a strong start. China continued to have a significant number of deals—some successful and others not. Indeed, 2016 marked the first presidential order proactively blocking the acquisition of a US business as well as CFIUS effectively requiring the abandonment of a multi-billion-dollar foreign-foreign deal due to national-security concerns. There have also been a number of political developments that may signal substantial changes to how the CFIUS process will operate going forward.

- CFIUS reviewed more than 170 transactions in 2016, well eclipsing the previous recent record of 155 in 2008. This surge likely reflected both strong cross-border M&A activity as well as an increased awareness among parties about the importance of submitting CFIUS filings. In addition to notified transactions, CFIUS also increased efforts to identify transactions of interest that were not voluntarily notified, so some of the filings undoubtedly reflect cases where parties originally chose not to file but later changed their minds after being “invited” to file by CFIUS. So far, 2017 has begun at an even faster pace than 2016, raising the very real possibility of a new record number of filings for the year.
- In conjunction with the rising number of CFIUS reviews, there have been some changes to the manner in which CFIUS manages the filing in-take process, which sometimes causes delays in the start of the formal review process. Historically, parties would pre-file a draft of their filing and then formally file their notice approximately a week or so later after addressing any questions and comments from CFIUS. CFIUS staff now routinely conduct more detailed reviews of prefiling and often ask extensive questions that must be addressed before the formal filing is submitted and accepted for review. This expanded pre-filing process enables CFIUS to get a head start on a review before the statutory time period begins and ask questions that may require significant time to address before subjecting parties to the three-business-day response period of the formal review. The process has also seen delays at times due to CFIUS staff having to manage a large volume of filings. As a result, the pre-filing period now often takes at least several weeks, so it is important to anticipate this additional time when planning deal timelines.
- CFIUS continues to interpret its jurisdiction broadly—including with respect to foreign-foreign deals with a US nexus. In the past year, the proposed acquisition of Lumileds from Philips NV, a Dutch company, by a Chinese consortium was abandoned at the request of CFIUS. CFIUS also recommended that the parties abandon a Chinese investor’s proposed acquisition of AIXTRON SE, a German company, because of alleged national-security concerns. The parties, who were engaged in a foreign-foreign transaction, chose not to follow CFIUS’ recommendation and to have the matter submitted to the US President, which led to the first-ever Presidential order pre-emptively blocking the acquisition of a US business (the two prior presidential blocks were post-closing divestment orders).

- In addition to the Lumileds and AIXTRON transactions, the sale of Global Communications Semiconductors, LLC to San'an Optoelectronics Co., Ltd., a Chinese semiconductor company, was also abandoned due to CFIUS concerns. In certain semiconductor-related transactions, CFIUS has expressed concerns about the potential defense applications of technologies that are already available in China, as well as the technical know-how of certain employees of the target companies.
- National-security review processes similar to CFIUS are gaining prominence in other countries and frequently must be evaluated in multi-national, cross-border transactions. For example, foreign acquisitions of businesses with operations in Australia, Canada, China, France, Germany and Russia, among others, can trigger national-security reviews in those jurisdictions.
- Since the last overhaul of the CFIUS statute in 2007, the continually evolving technological and political landscapes suggest that updates to the CFIUS process may be forthcoming soon. There have been increasing discussions in Congress about expanding CFIUS's role and authorities. In 2016, members of Congress submitted several letters to the Secretary of the Treasury urging CFIUS scrutiny of various transactions. Recent government reports have also highlighted a number of CFIUS-related concerns. A January report by the President's Council of Advisors on Science and Technology advocated using CFIUS and export control laws to limit Chinese advances in semiconductor technology and help ensure the United States' continued leading semiconductor technology position. The report also noted the importance of foreign national-security review processes becoming more active in controlling the exchange of technology in multi-national deals. Additionally, in November 2016, the US-China Economic and Security Review Commission issued a report to Congress recommending that Congress amend the CFIUS statute to empower CFIUS to block Chinese state-owned enterprises from acquiring US companies (currently only the President is authorized to block transactions). A report has also been requested from the Government Accountability Office to assess the adequacy of the current CFIUS process and whether it should be expanded, for example, to require review of all transactions involving Chinese state-owned buyers, include a "net economic benefit" test in addition to the national-security analysis, and consider reciprocity regarding how the investor country treats US investors in comparable industries.
- The CFIUS landscape under the new Trump Administration remains unclear and as of this writing the political appointees relative to the CFIUS process have not been finalized. That said, actions of the Trump Administration so far have shown a sharp focus on national security, so CFIUS is similarly likely to be aggressive when transactions present national security concerns. Given President Trump's focus on jobs, however, we expect that the United States' general policy of encouraging foreign direct investment will continue as foreign sources of capital via investments can spur expansion of companies, secure jobs in struggling companies, and lead to new hiring.
- In addition to CFIUS, there have been recent developments regarding other national-security processes. The Department of Defense's (DoD) Defense Security Service (DSS) administers the DoD's National Industrial Security Program, including the process that allows companies under foreign ownership, control or influence (FOCI) to obtain and maintain security clearances and perform on classified contracts. In 2016, DSS modified its longstanding approach to FOCI adjudication by announcing that it has transitioned to a risk-based analysis. This change in policy reflects DSS's recognition that threats to industry (e.g., from cyber-attacks) are expanding at a rapid rate and that the National Industrial Security Program Operating Manual (NISPOM), which addresses baseline security requirements for cleared companies, may not be sufficiently nimble to counter today's threats. Under this new approach, DSS will focus on the specific vulnerabilities of the relevant companies and determine ways to best protect against them, including by developing tailored security programs devised in coordination with the relevant companies.
- As part of its risk-based approach, DSS is also modifying how it addresses FOCI mitigation matters. Historically, DSS would apply mostly standardized FOCI mitigation measures based on a structured analysis of a number of broad FOCI categories. The new, risk based approach may lead to some companies requiring heavier mitigation measures in higher-risk cases and others seeing more flexibility where risks are lower.

The CFIUS process has undergone notable recent changes within the framework of its existing legal structure—including longer and more substantive pre-filing reviews, expansion of the scope of interest, and increased scrutiny of certain deals. Moreover, there may be sufficient political momentum for lawmakers to attempt to amend and expand the regulatory and statutory authorities granted to CFIUS. At the same time,

other countries have placed increased emphasis on their national-security processes to address potential risks from cross-border deals, making such reviews an important factor that must be considered in multi-national transactions. More than ever, investors and companies that may be involved in cross-border transactions need to consider the potential for national security scrutiny of their deals, including engaging in strategic planning to assess and address the potential risks and maximize their chances of success in the evolving political and regulatory landscape.

White & Case LLP
701 Thirteenth Street NW
Washington, District of Columbia 20005-3807
United States

T +1 202 626 3600

In this publication, White & Case means the international legal practice comprising White & Case LLP, a New York State registered limited liability partnership, White & Case LLP, a limited liability partnership incorporated under English law and all other affiliated partnerships, companies and entities.

This publication is prepared for the general information of our clients and other interested persons. It is not, and does not attempt to be, comprehensive in nature. Due to the general nature of its content, it should not be regarded as legal advice.