

Latham & Watkins Corporate Department

January 21, 2014 | Number 1633

CFIUS 2012 Annual Report Reveals Increase in Chinese Filings and Notice Withdrawals

The 2012 Report underscores the continued imperative for foreign investors to consider CFIUS issues when contemplating relevant US acquisitions.

The [Committee on Foreign Investment in the United States \(CFIUS\)](#) recently released the public version of its [2012 Annual Report](#). The Annual Report details how many notices were submitted to CFIUS in connection with investments by foreign investors in US businesses in 2012 and how many of those filings triggered investigations or were withdrawn. (CFIUS regularly publishes its annual reports almost a full year after the period for which the report is made. Thus, the 2012 Report was published at the very end of 2013 and does not include information about transactions filed in the past year.) Although the public version of the report does not include specific information about the transactions at issue, it does offer various insights into foreign investment trends, as well as factors CFIUS considers during national security deliberations.

Background

Through power delegated by the President under the Exon-Florio Amendment to the Defense Production Act of 1950, as amended, CFIUS considers the impact on US national security of “any merger, acquisition, or takeover ...by or with a foreign person which could result in foreign control of any person engaged in interstate commerce in the United States.” “Control” is broadly defined to include “the power, direct or indirect, whether or not exercised, through the ownership of a majority or a dominant minority of the total outstanding voting interest in an entity, board representation, proxy voting, a special share, contractual arrangements, formal or informal arrangements to act in concert or other means, to determine, direct or decide important matters affecting an entity.” Negative controls or “veto rights” over important matters can and often do give CFIUS jurisdiction over a transaction.

CFIUS is a multi-agency group chaired by the Secretary of the Treasury that includes, among others, the Secretaries of Defense, Homeland Security, State, Commerce and Energy and the Attorney General. Parties to transactions subject to CFIUS jurisdiction make “voluntary” filings with CFIUS to obtain clearance of those transactions (normally prior to closing), though CFIUS is authorized to commence a review without a filing (including after a transaction has closed). If CFIUS determines that a transaction threatens to impair US national security, the President can block or unwind the transaction.

Once parties to a transaction formally file a voluntary notice with CFIUS (which typically occurs only after pre-filing consultations with CFIUS) and that filing is accepted, the multi-agency Committee has 30 calendar days to conduct its review of the transaction and solicit additional information from the parties. CFIUS also can initiate a further investigation of the transaction during an additional 45-day period. If CFIUS believes the transaction threatens to impair US national security, CFIUS can propose conditions

that it believes would mitigate that perceived risk. In the rare case where such risks cannot be mitigated, or if the parties refuse to agree to proposed mitigation, the President has 15 days to review the transaction after the 45-day investigation period.

2012 CFIUS Annual Report: Highlights

- In 2012, filings in which a Chinese entity was a foreign acquirer dramatically increased. There were 23 such filings in 2012, compared to 10 in 2011 and only six in 2010. China for the first time led the list of acquiring countries with the most CFIUS filings in one year. Filings from UK foreign acquirers dropped from 25 in 2011 to 17 in 2012, while the number of cases in which Canadian and Japanese entities were foreign acquirers increased slightly from nine to 13 and seven to nine, respectively.
- In 2012, parties withdrew 22 of the 114 notices filed prior to the completion of the CFIUS process and during the initial 30-day review period. Of these 22 withdrawals, parties only refiled 12 notices with the committee.

This statistic stands in stark contrast to 2011, in which filers withdrew only six notices and ultimately refiled all of them. The report notes: “The increase in withdrawals in 2012 is a function of the specific facts and circumstances of the particular transactions reviewed by the committee.” Filers in 2012 may have walked away from these 10 transactions for business reasons unrelated to CFIUS review. However, CFIUS also may have proposed mitigation conditions that the filers found unacceptable, or filers may have abandoned transactions after CFIUS referred or indicated it would refer the relevant filings to the President.

- In the 2012 Report, CFIUS retreated from the conclusion reflected in its 2011 Report that at least one foreign country was probably executing a coordinated strategy to acquire US companies involved in research, development or production of critical technologies for which the United States is a leading producer. Instead, the 2012 Report notes that based on its assessment of 2012 activity, the US Intelligence Community judges it “unlikely that there is a coordinated strategy among foreign governments or companies to acquire such companies.”

This assessment represents a return to the position taken in CFIUS’s 2010 Report that the existence of such a coordinated acquisition strategy was unlikely. Despite this shift, our observation of CFIUS reactions to China-related cases continues to suggest that CFIUS views China and countries that are known to have close economic and military ties to China with heightened suspicion in terms of their potential to execute coordinated strategies to acquire leading-edge US technologies. CFIUS is likely to be particularly sensitive with respect to transactions involving Chinese government-owned or affiliated acquirers. However, even where subjected to heightened scrutiny, China-related transactions have continued to be approved by CFIUS.

- CFIUS commenced an additional investigation (and extended its initial review period into a further 45-day investigation period) in approximately 39 percent of cases in 2012, representing a slight increase as compared to 2011. This investigation rate is generally in line with the 38 percent of cases that CFIUS subjected to an additional investigation from 2009 through 2012. CFIUS proposed, and the parties accepted, mitigation measures in approximately seven percent of those cases. This mitigation rate is consistent with CFIUS’s eight percent average for use of mitigation measures in cases from 2010 through 2012.
- The President took action to prohibit one transaction in 2012, blocking (after-the-fact) a Chinese company’s ownership of wind energy farms in Oregon. This order — the second-only in CFIUS

history — also imposed controversial conditions on the required divestiture and resulted in litigation in federal court that ultimately affirmed the President’s authority to block such transactions. (Please refer to our prior [Client Alert](#) on this case.)

2012 CFIUS Annual Report: Trends and Statistics

- 2012 saw a slight increase in the number of “voluntary” notices filed with CFIUS. In 2012, CFIUS reviewed 114 notices, which represents a roughly three percent increase in filings compared to 2011, when CFIUS received 111 notices. In 2010, CFIUS received 93 notices.
- During the period 2008-2012, CFIUS received a total of 538 notices. Of those filings:
 - 41 percent (223 notices) related to the manufacturing sector (*i.e.*, computer and electronic products; transportation equipment; electrical equipment, appliances and components; machinery; chemical; fabricated metal products; primary metal; textile product mills; petroleum and coal products; and plastic and rubber products)
 - 33 percent (175 notices) related to the finance, information and services sector (*i.e.*, professional, scientific, and technical services; publishing industries not including Internet publishing; telecommunications; administrative and support staff; securities, commodities contracts, and other financial investments and related activities; credit intermediation and related activities; and waste management and remediation services)
 - 18 percent (96 notices) related to mining, utilities and construction (*i.e.*, utilities; support activities for mining; mining not including oil and gas; oil and gas extraction; heavy and civil engineering construction; specialty trade contractors; and building construction)
 - Eight percent (44 notices) related to wholesale and retail trade and transportation (*i.e.*, support activities for transportation; durable and non-durable goods merchant wholesalers; electronics and appliance stores; water transportation; transit and ground passenger transportation; and pipeline transportation)
- During the period from 2010 through 2012, approximately 21 percent of all filings involved a foreign acquirer from the United Kingdom. Approximately 12 percent of filings involved a foreign acquirer from China. Foreign acquirers from China, France, Japan, and Israel submitted approximately 10, nine, seven and five percent of all filings, respectively.
- In 2012, CFIUS continued to require parties to accept mitigation measures to ensure that their transactions would not threaten to impair U.S. national security, typically as a condition of CFIUS clearance. As noted above, CFIUS negotiated such measures in connection with eight different transactions. These mitigation measures included:
 - Ensuring that only authorized persons have access to certain technology and information.
 - Establishing a Corporate Security Committee and other mechanisms to ensure compliance with all required actions, including the appointment of a US government-approved security officer or member of the board of directors, as well as requirements for security policies, annual reports and independent audits.
 - Establishing guidelines and terms for handling existing or future US government contracts, US government customer information and other sensitive information.

- Ensuring only US 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 US government parties in advance of foreign national visits to the US business for approval.
- Notifying relevant US government parties of any awareness of any vulnerability or security incidents.
- Termination of specific activities of the US business.
- Mitigation agreements also provided for a variety of mechanisms for monitoring and enforcing subject companies' compliance, including:
 - Periodic reporting to US government agencies by the companies
 - On-site compliance reviews by US government agencies
 - Third-party audits when provided for by the terms of the mitigation measures
 - Investigations and remedial actions if anomalies or breaches are discovered or suspected
- Finally, the 2012 Annual Report suggests that CFIUS continues to focus on a number of areas of particular national security concern to CFIUS. These include the following:
 - Foreign control of US businesses that:
 - Provide products and services to government authorities with national security functions
 - Provide products or services that could expose national security vulnerabilities, including cyber security concerns and/or vulnerability for sabotage or espionage through the US business's position in the supply chain or otherwise
 - Implicate critical infrastructure, such as businesses in the energy sector (including extraction, generation, transmission and distribution), that affect the national transportation system or that directly affect the financial system
 - Have access to classified or other sensitive US government information
 - Are involved in activities related to weapons and munitions manufacturing, aerospace, and radar systems, or that otherwise do business in the defense, security or law enforcement sectors
 - Engage in research and development, production or sale of technology, goods, software or services subject to US export controls
 - Produce advanced technologies useful to national security, including those engaged in the design and production of semiconductors and other equipment or components with both commercial and military applications, or those involved in telecommunications and network data security

- Are in geographic proximity to certain kinds of US government facilities
- Acquisition of control by foreign persons that:
 - Are controlled by a foreign government
 - Are from a country with nonproliferation or other national security-related concerns
 - Have a history of taking or intending to take actions that could impair national security

The 2012 Annual Report underscores that it remains important for foreign investors interested in U.S. businesses in industries of national security concern, and those that implicate critical infrastructure, communications, information technology, national defense, or U.S. export controls, to anticipate the need to make a CFIUS filing and build sufficient time for the CFIUS review in the deal timeline. Latham & Watkins helps both US companies and foreign investors navigate the complex and interrelated federal regulatory regimes designed to safeguard US national security interests, including through all stages of the CFIUS process — from deciding whether to submit a “voluntary” notice to CFIUS, to drafting the notice and responding to further requests for information, to negotiating a mitigation plan if necessary to address concerns identified during the review.

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