

CFIUS annual report highlights spike in filings and scrutiny of Chinese investments

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The Committee on Foreign Investment in the United States (CFIUS or the committee), a U.S. government interagency committee that conducts national security reviews of foreign investments, has released its [annual report for 2016 and 2017](#). Although the report does not take into account cases reviewed by the committee after the enactment of the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA), which expanded CFIUS' jurisdiction and launched a mandatory filing pilot program, it offers some insight into the nature and extent of Chinese investment in the United States during what is widely considered to be the high-water mark of Chinese investment in this country. In particular, in 2016 and 2017, CFIUS' case load dramatically increased, as did the number of cases that proceeded to a second-stage investigation and the number of transactions that were abandoned on national security grounds.

We highlight below certain key features of the annual report:

- **Significant increase in number of notices filed.** CFIUS' annual report shows a steady increase in the committee's case load during the period 2008-2017. CFIUS reviewed 172 transactions in 2016 and 237 transactions in 2017, compared to 147 and 143 transactions in 2014 and 2015, respectively. Transactions in the "Finance, Information, and Services" sector showed the greatest growth, comprising 40 percent and 46 percent of all cases in 2016 and 2017, respectively, after comprising only 29 percent of all cases in 2015. Within this sector, the "Professional, Scientific, and Technical Services" subsector saw the greatest number of transactions reviewed by a significant margin. Although CFIUS has not released an annual report for 2018, the committee has released data showing that 229 notices were filed in 2018 – roughly consistent with volume in 2017.
- **China topped all foreign investors for the sixth year in a row.** For the fifth and sixth years in a row, stretching back to 2012, Chinese investors accounted for the largest number of notices filed. Of the 172 cases filed in 2016, 54 transactions, or roughly 31 percent of all cases, involved Chinese investors. Although Chinese investment in the United States has since plummeted – with the Rhodium Group reporting an 84 percent decline from the beginning of 2017 to the end of 2018 – 2017 appears to have been the high-water mark for Chinese investment in the United States. In 2017, transactions involving China rose to 60 filings but fell to roughly 25 percent of all cases. Investments from Canada, France, Japan, and the United Kingdom also featured prominently, which is consistent with prior reports.

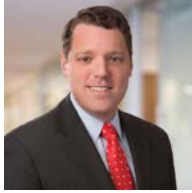
- **Nearly 75 percent of cases proceeded to investigation in 2017.** Although the percentage of CFIUS cases that proceed to the second-stage investigation has increased over the past several years, the historical high had been 49 percent. In 2017, CFIUS conducted an investigation in 73 percent of its cases – 172 of 237 notices reviewed. One potential cause of this significant increase in investigations in 2017 is the high volume of transactions, which, with no corresponding increase in resources, may have impeded CFIUS' ability to complete its review of cases during the initial review period, particularly in light of the initial lag in filling vacancies within the Trump administration. Other likely causes are the increased complexity of certain transactions and the large number of Chinese transactions in 2017; Chinese cases are frequently more challenging for CFIUS to process given the national security risks posed by such transactions, and, in some cases, more complex ownership structures. FIRREA may, in part, address the issue of a larger percentage of cases proceeding to an investigation, as the new law has extended the initial review period from 30 to 45 days. Our recent experience supports this view, as we are seeing an uptick in the number of transactions that CFIUS has concluded within the initial 45-day review period.
- **Huge spike in abandoned transactions.** In 2016 and 2017, parties to transactions filed with CFIUS withdrew 27 and 74 notices, respectively. Of the 27 notices withdrawn in 2016, the parties to these notices ultimately abandoned three of the underlying transactions for national security reasons, i.e., because (i) CFIUS informed the parties that it was unable to identify mitigation measures that would resolve its national security concerns, or (ii) CFIUS proposed mitigation measures that the parties chose not to accept. Of the 74 notices withdrawn in 2017, the parties to these notices ultimately abandoned 24 of the underlying transactions for the national security reasons described above. In contrast, in 2015 parties to transactions filed with CFIUS withdrew only 13 notices, three of which the parties ultimately abandoned for the national security reasons described above. The dramatic increase in transactions abandoned for national security reasons in 2016 and 2017 was likely due to the rise in Chinese investments (with the corresponding challenges they often present) and the Trump administration's efforts to develop and implement its approach to foreign investment security.
- **The president blocked one transaction in each of 2016 and 2017.** In 2016-17, the president blocked two proposed transactions on national security grounds, marking only the third and fourth times the president has taken such action under the CFIUS statute. Both transactions involved Chinese investors. In 2016, President Obama blocked the acquisition of the U.S. subsidiary of Aixtron SE, a German company, by another German company whose ultimate parent was a privately held Chinese company. Similarly, in 2017, President Trump blocked the acquisition of Lattice Semiconductor Corporation by a U.S. company ultimately owned by various Chinese state-owned entities. This active use of the president's power to block proposed transactions reflects the heightened scrutiny, during both the Obama and Trump administrations, of Chinese transactions during a period that saw a surge of Chinese investment in the United States.
- **Mitigation measures include limitations on intellectual property transfers.** The report highlights a form of mitigation not cited in prior CFIUS annual reports – "prohibiting or limiting the transfer or sharing of certain intellectual property, trade secrets, or know-how." This mitigation measure reflects CFIUS' growing concerns about the ability of foreign adversaries to make significant advances in the development of critical technologies by gaining access to core intellectual property and manufacturing know-how. CFIUS imposed mitigation measures in 12 percent and 13 percent of 2016 and 2017 cases, respectively, rates that are relatively consistent with recent CFIUS practice.

- **CFIUS identifies new types of U.S. businesses that raise national security risks if controlled by foreign investors.** CFIUS annual reports identify the types of U.S. businesses that, if controlled by foreign persons, could cause adverse consequences to U.S. national security. In the 2016 and 2017 report, CFIUS listed two additional types of U.S. businesses not described in prior reports: (i) ones that may "otherwise facilitate foreign intelligence collection against U.S. targets" and (ii) ones that, with respect to technologies of concern, "could facilitate their transfer to third parties not directly related to the buyer, to the detriment of national security." Consistent with CFIUS' concerns about foreign control of these types of businesses, we have recently seen CFIUS impose on allied country buyers mitigation measures that were focused on the potential threat posed by third parties, rather than the buyers.

Taken as a whole, CFIUS' annual report for 2016 and 2017 provides a useful snapshot of the foreign investment environment in the period preceding passage of FIRRMA. The report reflects the dramatic increase in CFIUS' case load and the apex of Chinese investment in the United States, two factors that FIRRMA was designed to address. Subsequent CFIUS annual reports likely will reflect the decrease in Chinese investment in the United States and ultimately the initial impacts of FIRRMA.

For further information or assistance regarding transactions potentially subject to CFIUS' jurisdiction or general CFIUS trends, please contact any of the Hogan Lovells attorneys identified below.

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