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CFIUS Annual Report Indicates Heightened Scrutiny for National Security Reviews of Foreign Investment

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The Committee on Foreign Investment in the United States (CFIUS) recently released its Annual Report to Congress regarding its activity during calendar year 2010. CFIUS is the inter-agency committee charged with reviewing foreign acquisitions of U.S. companies for national security implications and was made famous as a result of the Dubai Ports World investment in 2006. ^[1] CFIUS' annual report offers insights into the committee's approach to its national security-based review process as well as a confirmation of trends in foreign investment in the United States.

Key Highlights of the 2010 Report

CFIUS Filings Increased by Over 40%

In 2010, CFIUS reviewed 93 cases, up 43% from the 65 reviewed in 2009. Although the number of filings remained well below the pre-recession level of 155 notices in 2008, the rise can be viewed as reflecting a general increase in cross-border M&A activity. Notably, CFIUS filings for 2011 appear likely to exceed 2010 levels by about 20%.

Investigation Levels Remain High

Of the 93 notices reviewed in 2010, 35 (or nearly 40%) proceeded into the 45-day investigation stage, matching the percentage of cases investigated in 2009. These levels, however, are markedly higher than the 14% of cases that went into investigation in 2008, a trend that seems unlikely to change. The new CFIUS regulations and Executive Order, effective in 2008, have led to a more regimented process, with

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CFIUS more rarely waiving investigations on the grounds of minimal national security effect.

Mitigation Agreements Have Spiked

Nine cases resulted in binding mitigation measures in 2010, up from five in 2009. These mitigation agreements, which place conditions on the terms of the transactions and the post-acquisition operation of the target companies, were imposed on investments in the computer software, telecommunications and energy sectors. Mitigation agreements have increased significantly—there were only two in 2008—and are approaching pre-Executive Order ^[2] level of 14 cases involving mitigation agreements in 2007.

A Significant Number of Cases Have Led to Withdrawals

In 2010, there were 12 withdrawals from the CFIUS review process; six occurred during the 30-day review process and six during the 45-day investigation stage. Although most of the cases withdrawn were later refiled with CFIUS, it is interesting to note that in five of the 12 cases, the parties abandoned the transaction altogether. CFIUS did not prohibit any transactions in 2010.

The Manufacturing Sector Remains a Significant Acquisition Target

The highest proportion of filings (39%) occurred in the manufacturing sector, followed closely by the finance, information and services sectors. Foreign investors continue to see value in U.S. high-tech investments. Acquisitions of computer and electronics makers represented nearly half of all manufacturing sector investments, and computer system design and related services represented 36% of all service sector investments.

The UK Led CFIUS Filings, Followed by Canada, Israel, Japan, France and China

As has been the historical pattern, British companies submitted the most CFIUS notices in 2010, at 26. Canadian buyers participated in nine filings, Israeli and Japanese companies appeared in seven and French and Chinese investors each participated in six.

Further Background

General Economic Trends

As the report indicates, CFIUS filings during 2008 to 2010 coincided with trends in the broader market. CFIUS filings fell significantly over these three years, largely reflecting the global reduction in M&A activity prompted by the financial crisis that began in late 2008. As economies began to recover in 2010, however, foreign investment in the United States increased appreciably, a trend that appears likely to continue in 2011. Although final numbers are not publicly available, it appears likely that CFIUS will review 110 or more cases in 2011, still about 30 percent lower than 2008 levels.

Covered Transactions by Country

Companies from over 35 countries have filed CFIUS notices over the last three years, with more than 20 countries represented in covered transactions in 2010 alone. From 2008 to 2010, companies in the United Kingdom filed 91 notices with CFIUS, accounting for 29 percent of all CFIUS filings, the highest of any country. France had the second highest number, with 25 filings, followed by companies from Canada and Israel, each with 24 filings. Interestingly, Chinese companies have filed 16 CFIUS notices in the last three years despite high-profile CFIUS cases such as Huawei's, a Chinese telecom equipment manufacturer, forced divestiture of the U.S. technology company 3-Leaf and unsuccessful attempt to invest in 3-Com. Despite these set-backs, a number of Chinese companies have successfully navigated the CFIUS process without generating political opposition or undue publicity.

Further Information on Covered Transactions by Business Sector

CFIUS reviews cover foreign investments in a wide range of sectors that are not necessarily concentrated in defense or other traditional national-security related sectors. In 2010, approximately 39 percent of all investments came in the manufacturing sector, 38 percent were in the finance, information and services sectors, 14 percent were in the mining, utilities and construction sectors, and 10 percent were in the wholesale and retail trade area. These percentages largely mirror sector trends in CFIUS filings between 2008 and 2010, although investments in mining, utilities and construction have declined over the last three years. During this same three-year period, 48 percent of CFIUS notices filed within the manufacturing sector involved transactions within the computer and electronic products subsector, while 65 percent of transactions within the finance, information, and services sector involved financial services.

Summary

On the whole, the CFIUS process continues to function reasonably efficiently, if somewhat more mechanically than before 2008. The Annual Report for 2010 confirms that the committee will push more transactions into 45-day investigations and impose more mitigation agreements on parties to takeovers. Accordingly, investors should budget more time for the CFIUS process than might have seemed appropriate before 2009 and be prepared to respond to requests for substantive concessions that could affect post-acquisition management of U.S. targets. It remains to be seen how CFIUS's procedures would hold up if faced with a dramatic spike in inward foreign investment with potential national security implications.

Wiley Rein has more than two decades of CFIUS practice and direct knowledge of the CFIUS process. Nova Daly, who joined Wiley Rein from the Treasury Department, served as a Deputy Assistant Secretary from 2006-2009, and ran the CFIUS process as the CFIUS chair, overseeing more than 350 transactions.

[1] For a more detailed background on CFIUS, see <http://www.wileyrein.com/publications.cfm?sp=articles&id=5753>.

[2] Executive Order 13456, Jan. 23, 2008, 73 Fed. Reg. 4677 (Jan. 25, 2008).