

CFIUS Conducted More—and Longer—Reviews of Foreign Investments in 2010: Insights from the 2010 Annual Report of the Committee on Foreign Investment in the United States

On December 9, 2011, the Committee on Foreign Investment in the United States (CFIUS) released its annual report to Congress covering 2010. CFIUS' report reveals several trends in US national security review of foreign acquisitions that offer important insights for companies considering investments in the United States. The recent report reveals that (i) the number of transactions reviewed by CFIUS increased in 2010; (ii) more transactions are proceeding to the 45-day investigation stage; and (iii) CFIUS approval is more frequently contingent on the parties' entering into a mitigation agreement with CFIUS.

Background on CFIUS

CFIUS is an interagency committee led by the Treasury Department that is charged with reviewing foreign investments that may impact US national security and making recommendations to the president, who has the power to block transactions that threaten to impair national security. CFIUS reviewed over 550 transactions between 2006 and 2010. Although the president has only used his authority to block a transaction once since it was granted in 1988, President Obama came close to doing so last year. And it appears that many parties have decided to abandon their deals when it became clear that CFIUS was prepared to make a negative recommendation to the president.

The Latest CFIUS Trends

1. More CFIUS Notices Filed, Reflecting Improved Economy

The number of notifications submitted to CFIUS rose by 43 percent between 2009 and 2010 from 65 to 93. Although the number of transactions CFIUS reviewed in 2010 is still down substantially from the 155 reviewed in 2008 prior to the recession, the increase during 2010 may reflect the economic recovery in the United States and the level of interest of foreign investors in acquisition targets in the US market.

Manufacturing Companies Still Prime Targets, but More Finance, Information, and Services Deals: More of the transactions CFIUS reviewed in 2010 were in the manufacturing sector than any of the other three major sectors included in CFIUS' annual report (i.e., finance, information, and services; mining, utilities, and construction; and wholesale and retail trade). Many of these manufacturing deals were in the computer and electronic products

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subcategory; another large subcategory was transportation equipment involving aerospace products. However, manufacturing now makes up a significantly smaller percentage of the total number of CFIUS transactions than it did in the past, decreasing from 46 percent in 2008 to 39 percent in 2010. The percentage of finance, information, and services transactions, on the other hand, has consistently increased during that same period from 27 percent in 2008 to 38 percent in 2010.

British Companies Remain Most Active Acquirers: Acquisitions by investors in the United Kingdom accounted for more than 25 percent of all CFIUS notices in each of the past three years—far more than any other country. Although the percentage of UK transactions has declined from its high-water mark in 2008 when UK deals made up nearly 31 percent of CFIUS notices, acquisitions by UK investors still made up nearly 28 percent of the CFIUS notices filed in 2010. Canadian investors have accounted for the second largest number of CFIUS transactions in the past two years. This represents an increase from 2008 when Canada was tied for sixth. Canada, France, and Israel each account for approximately eight percent of all the CFIUS notices filed between 2008 and 2010 with between 24 and 25 transactions by investors from each country.

Although 52 percent of all CFIUS notices involving critical US technology were filed by investors from Western Europe, Chinese investors filed the fifth most CFIUS notices among foreign investors from any country in both 2009 and 2010. Despite efforts by senior officials in the Obama administration, including Treasury Secretary Geithner and President Obama himself, to reassure Chinese investors by emphasizing the United States' open investment policy, the number of CFIUS notices filed by such investors only increased by two from 2009 to 2010. Repeated objections by some members of Congress to attempts by high-profile Chinese companies to expand in sensitive areas of the US market, such as telecommunications, may have made Chinese businesses wary of the US market despite the executive branch's attempts to attract more Chinese capital. For example, Senator Jon Kyl, Representative

Ileana Ros-Lehtinen, and others in Congress have sent numerous letters, most recently on January 4, 2012, urging the administration to investigate Huawei, the Chinese telecommunications equipment manufacturer.

2. More Investigations Mean the CFIUS Process Takes Longer

The number of CFIUS notifications that resulted in an additional 45-day investigation after CFIUS's initial 30-day review increased to 35 in 2010 from 25 in 2009. Over the past two years, more than 40 percent of the notices that were not withdrawn during CFIUS' 30-day review were taken by CFIUS to the investigation stage. This increase in the number of investigations was accompanied by an increase in the number of notices withdrawn during the investigation stage from two in 2009 to six in 2010. Some foreign investors have also chosen to withdraw their notices toward the end of the 30-day review period and have immediately refiled new notices with additional information in an attempt to avoid proceeding to the investigation stage.

The major increase in the number of investigations from 2006-2007 (when the number of CFIUS notices subject to investigations was between four and eight percent of the total filed) can likely be attributed to changes made by the Foreign Investment and National Security Act (FINSA), which Congress passed in 2007 in the wake of the Dubai Ports World controversy. FINSA reduced CFIUS's discretion over whether to terminate its review after the initial 30-day review period by creating a presumption that CFIUS will conduct a 45-day investigation when the foreign acquirer is controlled by a foreign government (e.g., a state-owned enterprise) or when the transaction would result in control of critical infrastructure by a foreign person and CFIUS determines that the transaction could impair national security.

The rising number of investigations has important implications for potential foreign investors, especially those with significant government ownership or those seeking to invest in critical infrastructure. Foreign acquirers need to anticipate this potential delay and plan their deals

accordingly. For example, foreign companies may want to consider structuring their transactions and the related financing to accommodate the potential for a 90-day CFIUS process (i.e., the voluntary prefiling period that generally lasts approximately 15 days, a statutorily mandated 30-day review period, and the potential 45-day investigation period provided for by law).

3. More Mitigation Agreements Mean Ongoing Obligations for Foreign Acquirers

The number of legally binding “mitigation agreements” (i.e., commitments made by the parties to mitigate national security risks identified by CFIUS) that CFIUS negotiated with parties that filed notices in 2010 rose by nearly 50 percent from the five that were signed in 2009. CFIUS’ nine mitigation agreements in 2010 continue the trend from 2008 to 2009 when the number of mitigation agreements also nearly doubled. Notably, although CFIUS has only entered into 16 mitigation agreements since 2008, it entered into nearly that many each year between 2006 and 2007. Thus, the steady increase over the past two years may simply represent a readjustment back to CFIUS’ 2007 rate of entering into mitigation agreements prior to the passage of FINSA. In 2007, approximately 11 percent of the notices that were not withdrawn resulted in mitigation agreements, which is roughly the same percentage of mitigation agreements as in 2010.

CFIUS’ mitigation agreements in 2010 involved telecommunications, energy, and software companies; four different US government agencies were signatories to these agreements. The US government signatories in past years have included the Departments of Defense, Justice, and Homeland Security. Examples of the mitigation measures included in such agreements are:

- Establishing a Corporate Security Committee, a Security Officer, and similar mechanisms to protect US national security and ensure compliance with the agreement;
- Notifying the US government of security incidents and vulnerabilities as well as material changes to, or introduction of, relevant products or services; and

- Procedures to ensure compliance with terms for handling existing US government contracts and US government customer information.

CFIUS monitors compliance with mitigation agreements through on-sight compliance reviews by the lead US government agency, third-party audits, requiring the foreign acquirer (or the US company it invests in) to file periodic reports with the lead CFIUS agency, and investigating anomalies or security breaches and related remedial actions. The lead CFIUS agency assigned to each mitigation agreement is required to report back to the full Committee on its compliance monitoring.

The recent increase in the number of mitigation agreements has two important implications for foreign investors considering acquisitions in the United States that may impact US national security. First, the negotiation of a mitigation agreement complicates the CFIUS process and may delay approval of a transaction—in some cases, it could take months for the parties to reach agreements with multiple agencies on the appropriate mitigation measures. Second, foreign investors need to be prepared to fulfill ongoing compliance obligations if they are required to enter into a mitigation agreement in order to secure CFIUS approval.

Arnold & Porter’s Extensive Experience Can Help Clients Successfully Navigate the CFIUS Process

Arnold & Porter has an active and experienced CFIUS practice. The firm has successfully handled 15 matters before CFIUS in the last two years. Arnold & Porter assists clients with each stage of the CFIUS process, including prefiling advice, structuring the transaction, drafting and submitting the CFIUS notice, and answering questions from the Committee. Arnold & Porter also has industry-leading experience in negotiating and implementing CFIUS mitigation agreements and has worked on numerous arrangements to enable companies that will become subject to Foreign Ownership, Control, or Influence (FOCI) to retain or obtain work for the US government involving classified information.

The firm has handled a large number of deals involving close US allies, such as the United Kingdom, Canada, Norway,

and Italy. Arnold & Porter also has specific experience in transactions with acquirers from countries that pose unique political and security challenges, such as China and Russia, and in transactions that involve sensitive technology subject to stringent export controls under the International Traffic in Arms Regulations (ITAR), Export Administration Regulations (EAR), and laws and regulations administered by the Office of Foreign Assets Control (OFAC).

We hope you have found this Advisory useful. If you would like more information or assistance in addressing the issues raised in this Advisory, please feel free to contact:

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Many Arnold & Porter partners have worked on CFIUS matters as very senior US government officials. Arnold & Porter's practice is led by two former government officials, John B. Bellinger III, the former Legal Adviser for the Department of State and former Legal Adviser for the National Security Council during the Bush Administration, and John P. Barker, former Deputy Assistant Secretary of State for Export Controls in the Clinton Administration. Our team also includes former General Counsel of the Central Intelligence Agency Jeffrey H. Smith and former General Counsel of the National Security Agency Ronald D. Lee. This broad range of government experience allows Arnold & Porter to provide critical insights on policy and politics that can be valuable to clients navigating the CFIUS process. Our established relationships with CFIUS help clients develop and execute comprehensive strategies that address both legal and public policy challenges.

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