

CLIENT ALERT

CFIUS Annual Report Reveals Key Trends in Reviews of Foreign Investment

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AUTHORS

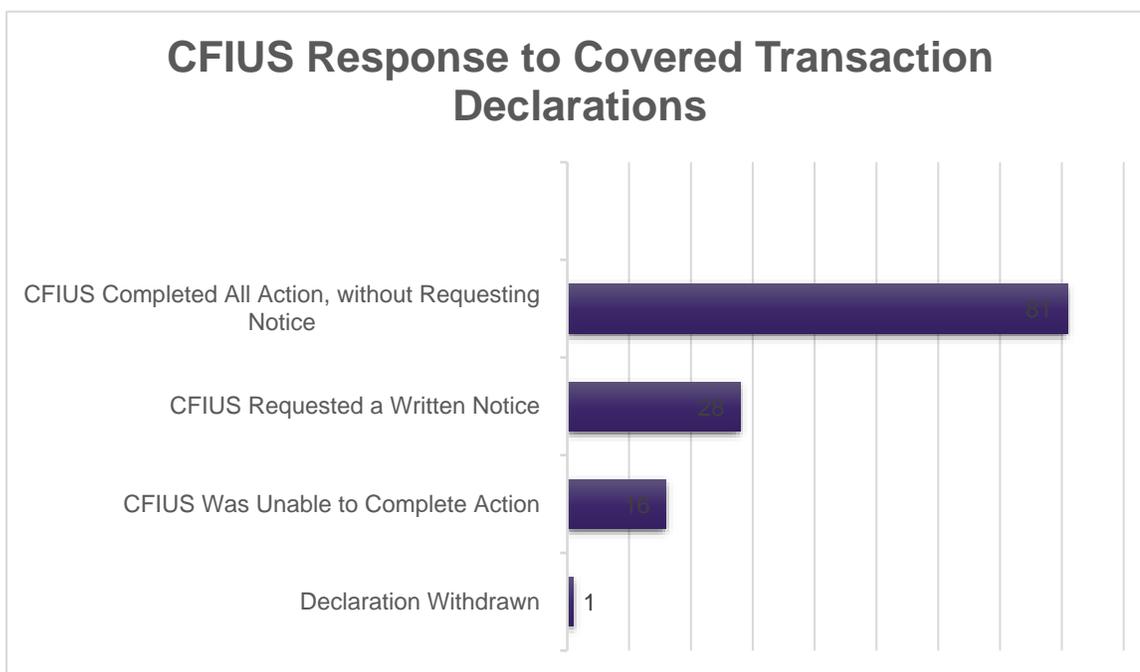
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In its first report following the full implementation of the Foreign Investment Risk Review Modernization Act of 2018 (“FIRRMA”), the Committee on Foreign Investment in the United States (“CFIUS” or the “Committee”) published its [Annual Report to Congress](#) for the 2020 calendar year (the “Report”) on July 26, 2021. In all, the Committee reviewed a total of **313 covered transactions** in 2020. Of these reviews, several trends have emerged that paint a picture of the U.S. government’s scrutiny of foreign investment, notably that reviews of investments by China have continued an overall downward decline from 2018 levels, the computer manufacturing and software development sectors saw the greatest number of reviewed transactions, and that CFIUS has stepped up its scrutiny of transactions that were not brought to the Committee’s attention. These trends, and others, are discussed in detail below.

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Declarations: Filings Increased as Did the Rate of Clearances by CFIUS

In 2020, CFIUS reviewed **126 “short-form” Declarations**-34 percent increase from the 94 Declarations filed in 2019-4 of which were subject to mandatory filing requirements based on stipulations provided by the parties. This significant increase from 2019 to 2020 in the number of Declarations filed is likely attributable to the fact that Declarations became available for all transactions, and not only those for which a filing was mandatory, following the expiration of the FIRRMA Pilot Program in February 2020.¹ In response to each Declaration, CFIUS took one of the following actions:



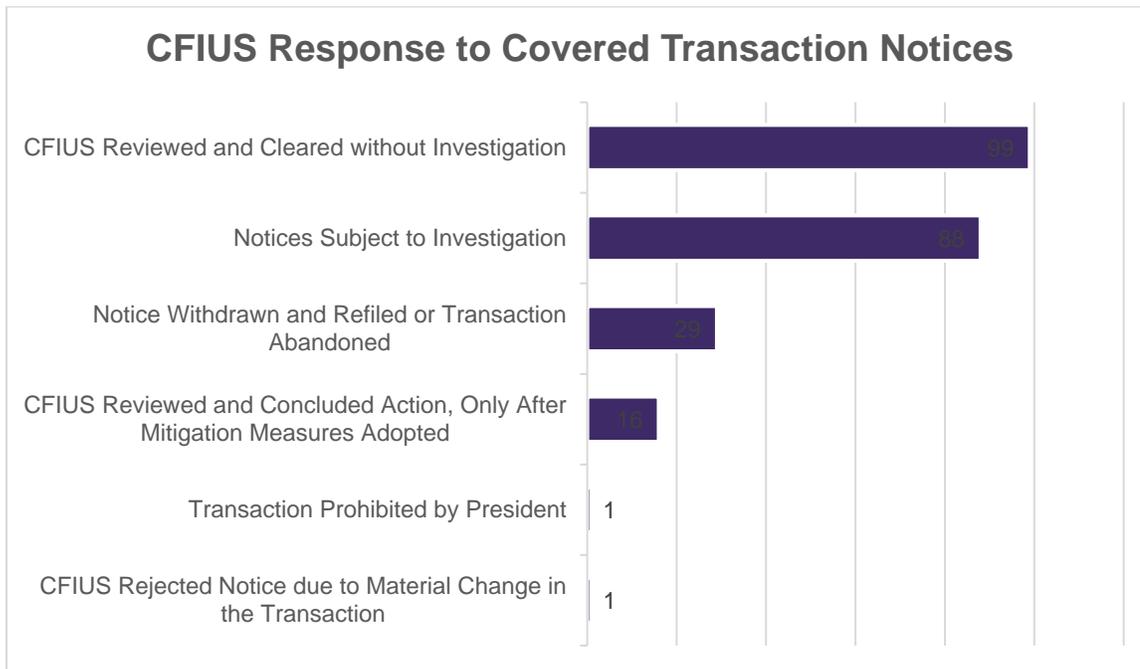
Significantly, CFIUS cleared 64 percent of the Declarations filed, compared to having cleared just 37 percent of the Declarations filed in 2019, despite having substantially more Declarations under review in 2020. Given such clearance rates, transaction parties will likely find the Declaration to be an increasingly attractive option in many cases.

¹ Throughout the reporting period, Declarations were mandatory for control transactions and certain non-controlling investments in U.S. businesses that involved “critical technology businesses,” and beginning on February 13, 2020, for certain covered transactions that involved significant foreign government interest in a “TID U.S. business.” For a more in-depth discussion of these concepts please see our Client Alert on the expanded CFIUS jurisdiction under FIRRMA: [Expanded CFIUS Jurisdiction Under FIRRMA Regulations: An Overview](#).

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Notices: Steady Decrease in Filings and Review Times

The **187 Notices** CFIUS reviewed in 2020 mark a steady decrease from the number of Notices reviewed in the prior three years.² This decrease may be explained by the fact that Declarations (instead of Notices) are required for certain transactions and voluntarily submitted in others, along with an overall decrease in M&A activity due to COVID and fewer transactions involving China (discussed below). Below is a high-level summary of the outcomes of CFIUS's review:



As indicated above, the President blocked only one transaction in 2020, which was the acquisition of Musical.ly, a Cayman Islands company, by ByteDance, Ltd., a Cayman Islands company currently headquartered in Beijing and controlled by Chinese persons, to the extent that Musical.ly or any of Musical.ly's assets are used in furtherance or support of, or relating to, Musical.ly's activities in interstate commerce in the United States. However, unique circumstances surrounding this transaction make it unlikely to guide future reviews by CFIUS.³

² Between 2017 and 2019, CFIUS reviewed 237, 229, and 231 notices, respectively.

³ The order to unwind ByteDance's 2017 acquisition of Musical.ly appears to have been connected to the Trump Administration's attempt to limit U.S. services to TikTok, the company that ByteDance merged Musical.ly with, via an August 2020 Executive Order, E.O. 13942. In September 2020, ByteDance sued the Trump administration to block E.O. 13942 from going into effect. In June 2021, President Biden reversed E.O. 13942.

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Notably, only 47 percent of the Notices filed proceeded to investigation, meaning that CFIUS was able to clear the majority of notices during its initial 45-day review period. This represents the highest proportion of notices cleared during the review phase in the last three years, suggesting that additional resources have helped CFIUS manage its case load.

Focus on Non-Notified Transactions

In recent years, CFIUS has stepped up its enforcement of non-notified transactions that occurred in the past, and 2020 was no exception. In 2020, there were 117 transactions that the Committee identified through the non-notified/non-declared process that were put forward to the Committee for consideration. Of those transactions, 17 resulted in a request by CFIUS that the parties submit a formal filing for review. The Committee's focus on non-notified transactions is consistent with overall U.S. policy towards enforcement of export controlled technology, and its concern with national security as it relates to infrastructure and the personal information of U.S. persons as relations continue to deteriorate with China. The Report notes that CFIUS is also stepping up efforts to train staff across CFIUS member agencies in order to increase coordination and identification of transactions to pursue. Going forward, it is increasingly likely that transaction parties who did not proactively file with CFIUS will be asked to submit a filing, so it is more important than ever for parties to analyze thoroughly their CFIUS risks.

More Filings from Allied Countries, Fewer from China

Four countries accounted for the vast majority of Declaration and Notice reviewed transactions in 2020. These transactions largely came from countries closely allied with the United States, notably Canada (20 Declarations, 11 Notices), Japan (18 Declarations, 19 Notices), the United Kingdom (12 Declarations, 14 Notices), and Germany (10 Declarations, 7 Notices). These numbers were only slight increases over 2019 transactions, though Canadian declarations increased noticeably from 12 to 20 in 2020. The number of Declarations stemming from investments from Chinese parties increased slightly from 2019 from three to five, including a single Declaration from Hong Kong, but the number of notices decreased from 55 in 2018, 25 in 2019, to only 17 in 2020. Hong Kong notices were zero in 2018, four in 2019, and three in 2020 for cases concluding prior to July 14, 2020.

The data provided in the Report strongly suggests that the Trump Administration's overall relationship with China had a chilling effect on investments from China. There was an overall decline in Declarations and Notices reviewed from 2019 (325) to 2020 (313), with a notable decrease in reviews of Declarations and Notices involving China coinciding with that decline even with the addition of Hong Kong after July 14 (28 in 2019 compared to 22 in 2020). It is arguable that the overall drop in total acquisitions reviewed is a result of the lack of investment from China, rather than the coronavirus pandemic, as the level of investment from other countries largely remained the same. These trends are likely to continue under the Biden administration, which has so far largely maintained the Trump Administration stance against China in terms of trade, sanctions, and export controls. Given the relationship with China and the rush to dominate technological

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sectors like computer hardware and software, especially in the context of the global semiconductor shortage, we expect that traditional U.S. allies will fill the void left by China in acquisitions of these particular industries.

Various Mitigation Measures Imposed by CFIUS in Nine Percent of Covered Transactions Filed in 2020

Frequently, CFIUS will require parties to a transaction to agree to measures to mitigate national security risks both in cases for which CFIUS has cleared the transaction and even in instances where the parties have voluntarily withdrawn a Notice. In 2020, CFIUS adopted mitigation measures and conditions with respect to 23 Notices of covered transactions, which was approximately 12 percent of the total number of Notices. For Notices filed in 2020, CFIUS concluded action after adopting mitigation measures with respect to 16 Notices of covered transactions constituting nine percent of total 2020 Notices. CFIUS required mitigation for three Notices that were voluntarily withdrawn or abandoned in 2020 to address residual national security concerns.⁴

In 2020, the Committee utilized several forms of mitigation measures to stem national security concerns. These included, but are not limited to, (1) prohibiting or limiting the transfer or sharing of certain intellectual property, trade secrets, or technical knowledge; (2) establishing guidelines and terms for handling existing or future U.S. Government contracts, U.S. Government customer information, and other sensitive information; (3) requiring security protocols to ensure the integrity of goods or software sold to the U.S. Government; and (4) notifying customers regarding the change of ownership. CFIUS will monitor compliance with these mitigation measures through reporting requirements, compliance reviews by U.S. Government staff, third-party audits, tracking systems, and requiring in-house expertise. It can be expected that the additional staff hiring CFIUS is currently pursuing to review non-notified transactions will also be utilized to increase scrutiny of mitigation measures.

There are currently 166 mitigation agreements in effect. CFIUS has not determined that there were any major violations of mitigation agreements or conditions in effect during 2020. Remediation agreements were instituted for three agreements stemming from minor violations, but the Committee took no enforcement actions as a result.

We do not expect that CFIUS will relax any of its current mitigation strategies, even if the parties involve allied countries such as Canada, the United Kingdom, or Japan. This would be in-line with the current trend of the United States putting greater enforcement on export controls in an effort to protect sensitive technologies, critical infrastructure, and the sensitive personal information of U.S. citizens.

⁴ The Committee expressly notes in the Report that the withdrawal of a Notice is a function of the particular facts and circumstances of the specific transaction being reviewed by the Committee and is not indicative of a trend.

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Additional Key Takeaways

Sectors with High Transaction Activity. Computer manufacturing and software development were the industrial sectors that saw the highest number of Declarations by a wide margin, with 33 Declarations between related sectors. Energy (13) and aerospace (7) were the other sectors with heavy foreign investment reviewed by CFIUS. Similarly, the largest number of Notices filed with CFIUS in 2020 involved foreign investment in the computer and electronic product manufacturing subsector and the professional, scientific, and technical services subsector. The clear focus by CFIUS on computer hardware manufacturing and software development reflects their importance to future economic growth and national security.

Very Few Real Estate Transactions. Out of the 313 Declarations and Notices submitted to the Committee in 2020, only five concerned real estate transactions involving proximity to U.S. military or sensitive government installations. It is unclear from this data if there were any transactions involving such foreign acquisitions of real estate, or if parties were just not submitting such transactions for voluntary review. Regardless, the Committee may be investigating such acquisitions of real estate as part of its stepped-up review of non-notified prior transactions.

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