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Newly-Released Data Reveal 50% Increase in CFIUS Filings Over Prior Year

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Each year, the US government releases a public version of a classified report to Congress summarizing the government's confidential review of certain foreign investments in the United States. The entity responsible for the report is an obscure committee of federal agencies and offices with national security responsibilities. Collectively, the members of the Committee on Foreign Investment in the United States ("CFIUS" or the "Committee") have the authority to block billion-dollar transactions pursuant to a review process that is not open to the public, and subject to only the narrowest judicial review.

Last month, CFIUS issued the public version of its most recent Annual Report to Congress. The new data offer a superficial (and somewhat stale) glimpse into the Committee's review of foreign investment transactions in 2014.

CFIUS is an inter-agency committee of the US government charged with reviewing certain foreign investment transactions that have the potential to raise national security concerns. While submitting to CFIUS review is nominally a "voluntary" process, the Committee is authorized to investigate transactions within its jurisdiction *sua sponte* to determine if they implicate national security issues.

In circumstances where CFIUS does identify a security concern, it is empowered to impose a broad range of mitigating measures on the transaction, including requiring the parties to divest sensitive assets and/or install a US proxy board in the foreign company. In cases where the parties have closed a deal before it came to the Committee's attention, CFIUS may unwind it.

Although the CFIUS review process is confidential and frequently involves consideration of proprietary and classified information, CFIUS annually releases a public report summarizing certain data relating to the transactions it reviewed in years prior (*e.g.*, the 2016 report contains CFIUS data from calendar year 2014).

Read more about the CFIUS review process

The most recent annual report

The new data released by CFIUS reveal that 2014 saw a dramatic jump in the number of cross-border M&A and other investment transactions reported to CFIUS as compared to 2013 (the Committee received 147 transaction Notices in 2014, up from 97 deals reported in 2013). For the third year in a row, Chinese acquirers were involved in more reported transactions than investors from any other country.

The 2014 figures represent a continuation of the trend of increased reporting since 2009, during which only 65 Notices were submitted. Further details of interest include the following:

- Of the 147 deals reported to CFIUS in 2014, 20 Notices were withdrawn by the parties during the initial 30-day review period during which the Committee conducts a threat assessment of the deal. CFIUS does not discuss the reasons for voluntary withdrawals, and the decision to withdraw a Notice can be motivated by a number of factors, including changed commercial circumstances, the perception that CFIUS will not approve the transaction, or that its approval will be conditioned on unpalatable terms.
- Following the initial 30-day review period, CFIUS initiated a further investigation of nearly one-third (51) of the transactions

reported in 2014. Under CFIUS' regulations, the Committee may initiate such an investigation if it is not able to resolve any perceived national security concerns during the initial review period. Notably, CFIUS is required to conduct an investigation if the foreign party to a disclosed transaction is controlled by a foreign government.

- Among the 51 transactions that were subject to a CFIUS investigation in 2014, the parties to nine deals decided to withdraw their Notice and abandon their transactions.

Recent case studies

While the Committee's Annual Reports do not disclose details about specific transactions, recent press coverage has focused attention on several high-profile deals that ran into trouble during the CFIUS review process. The publicly-disclosed details about these transactions emphasize the need to think *early* and *broadly* about potential CFIUS risks when contemplating any foreign investment in a US company.

Philips / GO Scale Capital

In January, Dutch-based Philips abandoned a $2.9 billion deal to sell an 80% stake in its LED lighting business ("LumiLEDS") to GO Scale Capital, based in China. That decision is noteworthy because the deal did not involve obvious national security concerns. LumiLEDS primarily produces lighting components used in automobiles, and for backlighting in consumer electronics like smartphones and televisions. Some commentators, however, have speculated that LumiLEDS may also have developed infrared or sensory technologies that could be used in advanced security applications. Others note that the equipment used to manufacture high-efficiency LEDs also can be used to produce export-controlled photovoltaic solar cells. Whatever the reason for the Committee's concerns, Philips has stated that CFIUS informed the company that Philips could not have been aware of the reason for the government's objections prior to undergoing CFIUS review.

Unisplendour / Western Digital

In February, the Tsinghua Unisplendour Corporation of China ("Unisplendour") walked away from a $3.78 billion deal to become the largest shareholder in US-based hard disk drive manufacturer Western Digital. The demise of this transaction is notable because the parties did not contemplate a traditional merger or acquisition, but rather a minority investment to acquire only 15% of Western Digital's stock. However, because the deal terms also entitled Unisplendour to nominate a member to Western Digital's board, the transaction arguably constituted a "covered transaction" under the CFIUS regulations, thus bringing the deal within the Committee's jurisdiction to review. Unisplendour announced its decision to abandon the deal after CFIUS initiated a *sua sponte* review of the transaction, suggesting that in some circumstances, the specter of CFIUS review alone presents more uncertainty than the parties are willing to assume.

Fairchild Semiconductor / China Resources Microelectronics

Also in February, US-based Fairchild Semiconductor ("Fairchild") turned down a $2.6 billion takeover bid from China Resources Microelectronics ("CRM"). Here, the transaction appeared to involve obvious potential national security concerns. Fairchild manufactures three-dimensional motion sensors used in maritime surveillance and to guide unmanned submarines and drones, and CRM is backed by state-owned China Resources Holdings. Presumably to account for CFIUS risk, CRM originally offered Fairchild $21.70 per share and a $108 million termination fee if the transaction did not receive regulatory approval. After Fairchild raised concerns about the CFIUS review process, CRM raised its offer to $22.00 per share. Notwithstanding this higher offer, however, the Fairchild board is said to currently favor a lower bid of $20.00 per share from a US company which would not involve CFIUS review. This result appears to illustrate the price premium that foreign investors may face where a target's business operations implicate national security issues, and the corresponding leverage that US investors may have relative to their foreign competitors.

Assessing and mitigating potential CFIUS risks

In light of the Committee's broad jurisdiction, and its extraordinary authority to prohibit, modify, and even unwind transactions that have the potential to threaten US national security interests, parties to transactions involving US businesses and foreign investors need to understand the contours of CFIUS' jurisdiction, and the risks of engaging in any transaction subject to CFIUS review.

While each transaction is unique, and while the CFIUS review process always will involve significant elements of subjectivity and judgment on the part of the government, certain fundamental touchstones of a CFIUS risk assessment remain constant. Companies contemplating a foreign investment transaction can begin their risk analysis by considering the following, among other issues, before proceeding with their deal:

- The industries in which the US business target operates;
- The nature of the US target's technology (*e.g.*, whether any of its technology is subject to US export control laws);
- The US target's current and historical customer base (*e.g.*, whether its customers include any US government agencies or government contractors); and
- The nationality of the foreign entity to the transaction.

Naturally, the answers to these and other relevant questions are not dispositive of any CFIUS analysis, but they should provide a basis for discussion between the parties regarding what further diligence is warranted, and how to discuss risk-shifting and mitigation going forward.

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