

In December 2012, The Committee on Foreign Investment in the United States (CFIUS) publicly released an unclassified version of its Annual Report To Congress for the calendar year 2011 (Report). The full version of the Report as well as other unclassified reports from the previous five years can be accessed at:

<http://www.treasury.gov/resource-center/international/foreign-investment/Pages/cfius-reports.aspx>.

While the publicly released version of the Report does not disclose detailed information about the transactions, it nevertheless provides valuable information, especially for foreign companies considering acquisitions in the U.S., as to structuring transactions when involving CFIUS clearance.

Overview of CFIUS Review

CFIUS is an inter-agency committee of the U.S. federal government authorized to review “covered transactions” in order to determine the effect that such transactions may have on the national security of the U.S. CFIUS pays particular attention to transactions involving acquisition of “critical infrastructure” or “critical technologies” of the U.S. CFIUS has authority to issue, monitor and enforce mitigation measures to address any national security concerns and if CFIUS finds that a transaction raises national security concerns, CFIUS notifies the President of the U.S., who can ultimately block a transaction to protect the national security of the U.S.

The term, “covered transactions” includes all “mergers, acquisitions, and takeovers [that] could result in foreign control of persons engaged in interstate commerce in the United States.” In addition to acquisitions, “covered transactions” can include long term leases and joint ventures. However, the following transactions are not considered “covered transactions”: (1) greenfield investments, (2) property or facility without other business components, (3) assets or commodity purchases, (4) service or license agreements, (5) minority investment protections (security underwriting, insurance and lending that do not confer control in the circumstances, passive investments), and (6) incremental acquisitions following CFIUS clearance.

“Critical infrastructure” is defined as “systems and assets, whether physical or virtual, so vital to the United States that the[ir] incapacity or destruction... would have a debilitating impact on national security, national economic security, national public health or safety.” It is presumed that transactions involving “critical infrastructure” implicate national security.

“Critical technologies,” includes, under Section 800.209 of the Regulations Pertaining to Mergers, Acquisitions, and Takeovers by Foreign Persons (CFIUS Regulations), defense articles or services covered by the United States Munitions List, which is set forth in the International Traffic in Arms Regulations (ITAR) (22 C.F.R. parts 120-130), as well as items specified on the Commerce Control List set forth in Supplement No. 1 to part 774 of the Export Administration Regulations (EAR) (15 C.F.R. parts 730-774), including items that can assist in the proliferation of nuclear, chemical and biological weapons or missile technology. It also includes items that are specially designed and prepared nuclear equipment, parts and components, materials software, and technology specified in the Assistance to Foreign Atomic Energy Activities regulations (10 C.F.R. part 810), and nuclear facilities, equipment, and material specified in the Export and Import of Nuclear Equipment and Materials regulations (10 C.F.R. part 110); and select agents and toxins specified in the Select Agents and Toxins regulations (7 C.F.R. part 331, 9 C.F.R. part 121, and 42 C.F.R. part 7).

The CFIUS Annual Report: What Lessons Can Be Learned?

Coordinated Strategy to Acquire U.S. Critical Technologies

Perhaps the most noteworthy item in the Report is the assertion that CFIUS, for the first time, notes that the U.S. Intelligence Community (IC) “judges with moderate confidence that there *is likely* a “coordinated strategy”¹ among one or more foreign governments or companies to acquire U.S. companies involved in research, development, or production of “critical technologies” for which the United States is a leading producer.” (emphasis added)

While information supporting this assessment has been only provided in the classified version of the Report, the public version of the report does give examples of suspect behaviors that could be evidence of a coordinated strategy, which include the following:

- A pattern of actual or attempted acquisitions of U.S. firms by foreign entities;
- Evidence that specific completed or attempted acquisitions of companies with critical technologies had been ordered by foreign governments or foreign government-controlled firms; or
- The provision of narrowly targeted incentives by foreign governments or foreign government-controlled firms (e.g. grants, concessionary loans, or tax breaks), especially those that appear to market observers to be disproportionately generous, to acquire U.S. firms with critical technologies.

Based on the above, this reference seems to include China as one of the foreign governments that may be part of a coordinated strategy to acquire U.S. companies involved in research, development or production of “critical technologies” for which the U.S. is a leading producer. Perhaps this is related to the Chinese government’s mandate for its companies to “go out” (走出去) or “go global” (走向世界), and the related trend by Chinese companies to acquire more U.S. companies.

CFIUS Uses Multiple Ways to Identify Transactions

CFIUS identifies transactions involving the acquisition of “critical technology” by foreign persons through a combination of publicly available information, non-public data on M&A transactions that CFIUS reviewed, and the internal records of the various CFIUS agencies responsible for administering U.S. export controls. The Department of State is the most helpful agency in identifying transactions involving acquisition of critical technologies by foreign persons, because it maintains a robust registration, licensing and compliance process for any person involved in the export of ITAR controlled items. Accordingly, one must presume that the Department of State will notify CFIUS anytime it receives a notification of a material change to an ITAR registrant that could result in foreign control of the registrant.

¹ The Appendix to the 2012 Report states that CFIUS agencies continue to use the following definition of “coordinated strategy”: “A plan of action reflected in directed efforts developed and implemented by a foreign government, in association with one or more foreign companies, to acquire U.S. companies with critical technologies. The efforts of a single company in pursuit of business goals, absent indications of specific government direction, were not considered to be a coordinated strategy. Individual company strategies encompass such business goals as: entry into the U.S. market; increased market share; increased sales; access to new technologies; and diversification out of mature industries.”

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U.K. and France Dominate Acquisitions of U.S. Critical Technology

In 2011, CFIUS and IC identified 114 planned or completed mergers with, or acquisitions of, U.S. “critical technology” companies involving acquirers from 33 different countries and economies in different industry sectors. The following are the top 10 countries represented in such transactions:

1. United Kingdom (30 transactions)
2. France (13 transactions)
3. Japan (8 transactions)
4. Canada (7 transactions)
5. Netherlands (7 transactions)
6. Germany (6 transactions)
7. Israel (5 transactions)
8. Switzerland (5 transactions)
9. China (4 transactions)
10. Singapore (4 transactions)

The top 3 industry sectors represented in the “critical technology” transactions include: (1) Machinery and Equipment with 34 transactions, (2) Information Technology with 26 transactions, and (3) Electronics with 22 transactions. Surprisingly, only 4 transactions were in the Aerospace and Defense industry sector.

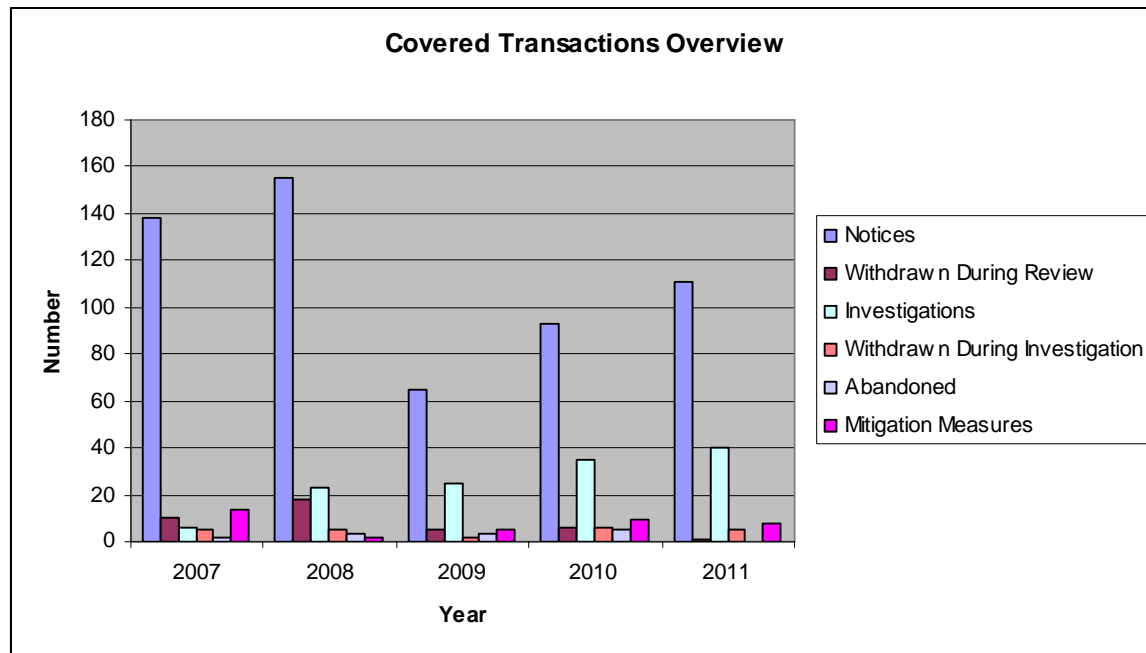
Covered Transactions Overview

The following chart lists the number of notices filed with CFIUS in the years 2007 through 2011 as well as how many of them went on to the investigation phase. The chart also lists the number of notices that were withdrawn during each of the phases, and the number of transactions that were abandoned as well as the number that were subject to mitigation measures. As shown below, the U.S. President did not take action on any of the covered transactions during the period from 2007 through 2011.

Year	Notices	Withdrawn During Review		Investigations		Withdrawn During Investigation		Abandoned		Mitigation Measures		Presidential Decisions
		#	%	#	%	#	%	#	%			
2007	138	10	7%	6	4%	5	83%	2	1%	14	10%	0
2008	155	18	12%	23	15%	5	22%	3	2%	2	1%	0
2009	65	5	8%	25	38%	2	8%	3	5%	5	8%	0
2010	93	6	6%	35	38%	6	17%	5	5%	9	10%	0
2011	111	1	1%	40	36%	5	13%	0	0%	8	7%	0
Total	562	40	7%	129	23%	23	18%	13	2%	38	7%	0

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The following graph uses the data listed in the chart above to help illustrate trends. Our observations of the data and trends are summarized below.



Steady Increase in Notices Filed with CFIUS

As illustrated by the chart and graph above, there was an increase in the number of notices filed with CFIUS from 2007 to 2008, followed by a sharp decline in 2009. The sharp decline from 2008 to 2009 appears to be attributed to the global recession.

Since 2009, there has been a steady increase in the number of notices of covered transactions that have been filed with CFIUS. The recent steady increase in the notices filed with CFIUS is probably also attributed to the fact that CFIUS and its individual agencies have become more aggressive in proactively monitoring potential transactions and have been reaching out to parties to recommend that they voluntarily file the notice.

General Reduction in Withdrawals in Review Period

There has been a general decrease in the last 4 years of the percentage of notices filed that were withdrawn during the initial 30 day "review" period and not a significant difference in the percentage of notices withdrawn during the "investigation" phase. The decrease of the withdrawals during the review period is probably attributed to the increased use of pre-notification meetings and/or conference calls, which have helped parties to better anticipate upfront the type of additional information that will be requested of them by an agency as well as any concerns that CFIUS may have in the way the transaction is currently structured.

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To further understand the underlying cause of the above trend, it is helpful to keep in mind why and under what circumstances parties may withdraw a transaction from CFIUS review. Parties can only withdraw an accepted notice of a transaction if CFIUS approves a written request for withdrawal from the parties. Historically, parties have requested a notice be withdrawn for various reasons. Sometimes parties request that a notice be withdrawn, because CFIUS has informed the parties that the transaction as currently structured will pose national security risks and thus gives the parties an opportunity to withdraw, change the structure and re-file the notice later or abandon the transaction altogether. More often than not, the reason why parties withdraw from an accepted notice is because an agency of CFIUS has later requested for a significant amount of information that the parties know they will not be able to assemble within the 3 day response time and thus parties withdraw to re-file at a later time once all the information has been assembled.

While not mentioned in the Report, in recent years there has been an increase in the number of parties to a transaction requesting pre-notification meetings or telephone conference call with CFIUS. Indeed, such pre-notification meetings are helpful and encouraged. Parties requesting such meetings are requested to submit a draft version of the notice to CFIUS roughly one week prior to the scheduled meeting or conference call, which gives CFIUS representatives an opportunity to review the draft version of the notice and guide the parties in case the notice needs to be modified before it is considered accepted. At this time, CFIUS representatives often inform the parties of additional information which, although not technically required to be submitted under the CFIUS Regulations, will likely be requested by one or more agencies of CFIUS.

Increase in Number of Filings that go to Investigation Phase

There has been a steady increase in the number of transactions that move from the initial 30 day review period to the additional 45 day "investigation" phase. In fact, during the past 3 years, more than 1/3 of all transactions notified to CFIUS have gone into the investigation phase. A notice generally goes to the investigation phase if CFIUS is not able to resolve all outstanding national security concerns within the initial 30 day review period. This increase is probably due to the increased coordinated effort among the various agencies that are part of CFIUS as well as an increased involvement by those agencies, since additional time would be required if more people are reviewing and scrutinizing the information provided.

Mitigation Measures in Computer and Electronics Industry Sectors

CFIUS continues to actively impose mitigation measures on transactions in order to address national security risks. Mitigation measures are ordinarily used in transactions that CFIUS determines will result in foreign ownership, control or influence over a U.S. company that has access to classified information. The mitigation measures taken by CFIUS vary based on the facts and circumstances surrounding the transaction. A simple board resolution may be required in a situation where a minority foreign investor will not have the power to appoint a board member, whereas a more complicated voting trust agreement may be required where a foreign parent company must relinquish direct control over the U.S. company.

As shown in the below chart, certain industry sectors have been repeatedly represented in transactions that have required the use of mitigation measures. The computer and the electronics sectors seem to be the ones that have required the most mitigation measures. In 2011, a total of 8 different mitigation measures were required involving 6 different industry sectors.

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Year	Total Notices	Mitigation Measures		Industry Sector
		#	%	
2007	138	14	10.1%	Basic manufacturing; energy; operations services for the aviation and maritime industries; and information technology, both hardware and software.
2008	155	2	1.3%	<i>industry sector information not provided*</i>
2009	65	5	7.7%	Computer software, telecommunications, and energy sectors.
2010	93	9	9.7%	Computer software, telecommunications, and energy sectors.
2011	111	8	7.2%	Software, computer programming, computer and electronic manufacturing, electrical equipment and component manufacturing, aerospace manufacturing and finance.

CFIUS Adds to List of National Security Considerations

Like in previous reports, the Report includes a list of some of the broad range of national security considerations presented by transactions reviewed by CFIUS. One difference from the previous reports, though, is that the Report includes considerations that CFIUS has never previously mentioned. These additional considerations include whether the transaction would result in foreign control of U.S. businesses that: (1) are in proximity to certain types of U.S. Government facilities, (2) involve various aspects of energy production, including extraction, generation, transmission, and distribution, (3) have access to sensitive government or government contract information, including information about employees, and (4) are involved in activities related to satellite systems. CFIUS has stated that it will continue to take into account all the national security considerations listed, including the additional ones it has added for the first time, in the transactions that it reviews in the next reporting period.

It is not too surprising that CFIUS has mentioned that it will also consider the location of a proposed transaction, given that the U.S. President ordered the unwinding of a transaction involving acquisition of wind farms in Oregon due to its proximity to a U.S. naval air base. Unfortunately, the Report only says "certain" types of U.S. Government facilities and does not provide details as to what types of U.S. Government facilities will be significant for a transaction to present national security concerns.

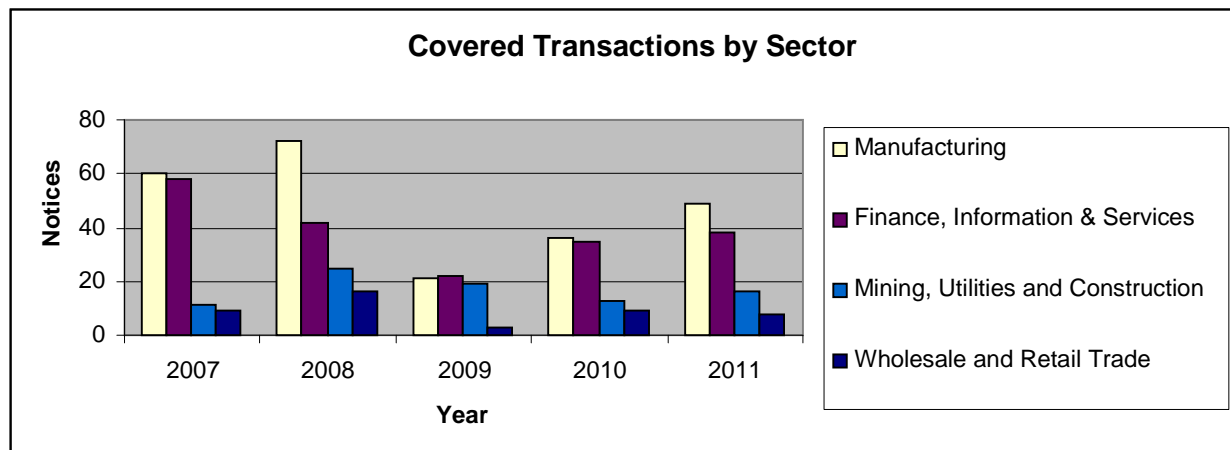
Manufacturing Continues to be the Dominate Sector

As the following chart and graph show, the Manufacturing sector still dominates the covered transactions notified to CFIUS, followed by the Finance, Information & Services sector. The largest subsector of the manufacturing industry has over the past five years consistently been Computer and Electronics Products (roughly 41%), which includes navigation, measuring electromedical, and control instruments manufacturing, semiconductor and other electronic component manufacturing, communications equipment manufacturing and computer and peripheral equipment manufacturing. The greatest subsectors of the Finance, Information & Services sector is computer system design and related services, followed by Architectural, Engineering and Related Services (33%).

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It would be helpful to see how many of the total transactions involve the computers and electronics subsectors, since varied forms of each are included in both of the main Manufacturing and Finance, Information & Services sector.

Year	Notices	Manufacturing		Finance, Information & Services		Mining, Utilities and Construction		Wholesale and Retail Trade	
		#	%	#	%	#	%	#	%
2007	138	60	43%	58	42%	11	8%	9	7%
2008	155	72	46%	42	27%	25	16%	16	10%
2009	65	21	32%	22	34%	19	29%	3	5%
2010	93	36	39%	35	38%	13	14%	9	10%
2011	111	49	44%	38	34%	16	14%	8	7%
Total	562	238	42%	195	35%	84	15%	45	8%



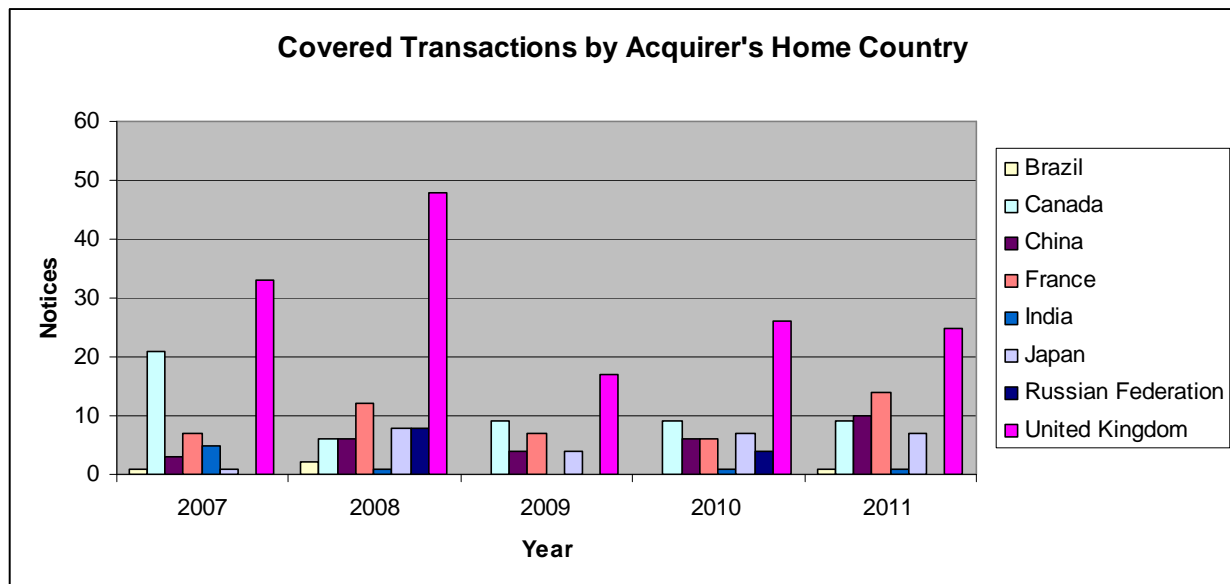
Increase in Chinese Transactions

As the following chart and graph show, while the United Kingdom still leads in the number of acquisitions of U.S. companies by foreigners, the past three years shows a noticeable increase in the number of transactions involving acquisitions by Chinese companies.

The following chart lists the top 5 countries plus Brazil, India and the Russian Federation that were represented in the notices filed with CFIUS along with the number of notices filed in the past five years. It is interesting to note that none of the notices filed with CFIUS included an acquisition by a Mexican company.

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Country	2007	2008	2009	2010	2011	Total
Brazil	1	2	0	0	1	4
Canada	21	6	9	9	9	54
China	3	6	4	6	10	29
France	7	12	7	6	14	46
India	5	1	0	1	1	8
Japan	1	8	4	7	7	27
Russian Federation	0	8	0	4	0	12
United Kingdom	33	48	17	26	25	149



Lessons Learned

A few trends can be gleaned from the Report that, together with what we have observed in the course of assisting our clients in the CFIUS process, can serve as a guideline for foreign companies considering acquiring or investing in a U.S. company:

1. The foreign company should not commit to entering into a transaction (including signing any purchase agreement, letter of intent or memorandum of understanding) until it has considered and discussed with the seller whether a notice will be jointly filed with CFIUS.
2. The parties to the transaction should determine whether CFIUS clearance will be a condition to closing and which party will bear the risk in the event CFIUS clearance is not obtained or mitigation measures are required.

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3. Consider structuring the transaction to lessen concerns about CFIUS review.
4. The foreign company should plan enough time to assemble the items that will need to be submitted with the CFIUS notice. It can take several weeks for the required information to be assembled and the notification to be drafted.
5. The foreign company needs to do its homework on the target company and to work with competent legal counsel to conduct comprehensive due diligence on the target company's export control and cyber security compliance programs. Information on the target company's government contracts, including classified contracts, over the past five years will be required.
6. If the target company is subject to export controls, ask the seller whether the company has ever applied for any export control licenses to export to any national or company from your home country and if so, the result of the license request. In addition, obtain copies of the target company's export control compliance program and cyber security plan.
7. Once it is determined that CFIUS notification is advisable, a request for a pre-notification filing in-person meeting or conference call with CFIUS representatives can be very helpful.

Contact us if you'd like assistance.

Richard A. Walawender
Director, Corporate Group
+1.313.496.7628
walawender@millercafield.com

Gurinder J. Singh
Principal, Corporate Group
+1.212.704.4414
singh@millercafield.com

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