

Biden administration seeks 'robust consideration of evolving national security risks'

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National security review has shifted profoundly over the past four years. President Biden issued a first-ever Executive Order¹ (the Order) to provide "formal Presidential direction" on the risks that the Committee on Foreign Investment in the United States (CFIUS or the Committee) is to consider when reviewing covered foreign investments in the United States.

The Order followed the Committee's August release of its Annual Report to Congress² for calendar year 2021 (the Report). Together the documents offer unprecedented insight into how President Biden's administration evaluates the national security risk arising from foreign investment in the United States.

The Committee is to consider relevant ties by the foreign buyer and its investors or other third parties "that might cause the transaction to threaten to impair the national security of the United States."

CFIUS is an interagency body of the U.S. Government authorized by law to review and address national security risks arising from certain transactions involving foreign investment in the U.S. It is led by the United States Department of the Treasury and includes the departments of defense, state, justice, commerce, energy, and homeland security.

The Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) significantly changed CFIUS's process by expanding the types of transactions subject to CFIUS review and mandating notification to CFIUS regarding certain foreign investments in critical technologies, among other changes.

FIRRMA strengthened CFIUS to enhance its ability to address national security concerns by broadening the authorities of the President and CFIUS to review and address any national security concerns arising from investments, and the Order focused that authority further.

CFIUS reviews "covered transactions," which are any proposed or pending transactions with a foreign person that could result in

control over a U.S. business. Covered transactions include but are not limited to deals structured as stock or asset purchases, foreign-to-foreign transactions where the target has U.S. assets, joint ventures into which a U.S. business is being contributed, and, under FIRRMA, certain non-control direct and indirect investments.

Parties to a covered transaction typically have the option to voluntarily notify CFIUS of the transaction to solicit a review. FIRRMA established mandatory reporting to CFIUS of some transactions, such as critical technology, critical infrastructure, and personal data collection operation transactions. CFIUS can review a covered transaction whether the parties voluntarily notify CFIUS or not, and there is no statute of limitations for CFIUS review.

FIRRMA also implemented a short-form (five-page) declaration process (a Declaration) to complement the existing, more extensive, joint voluntary notice process (undefined length but frequently extensive) (a Notice). CFIUS must review declarations within 30 days and notices within 45 days, with an additional 45 days for investigation (and an additional 15 days in extraordinary circumstances).

If the parties elect to submit a Declaration, CFIUS has authority to inform the parties that the Committee cannot conclude action regarding the transaction based on the Declaration. In that case CFIUS may choose not to direct the parties to file a Notice; to direct the parties to file a Notice; to initiate a unilateral review of the transaction; or to notify parties that the Committee has concluded all action.

If CFIUS determines that the transaction poses no unresolved national security concerns, then CFIUS will conclude all action regarding a transaction.

If the parties and CFIUS agree on mitigation measures and CFIUS determines that those measures adequately address any unresolved national security concerns, then CFIUS will conclude all action regarding a transaction.

Additionally, if CFIUS determines that any national security concerns are adequately addressed by laws other than Section 721 of the Defense Production Act of 1950 and the International Emergency Economic Powers Act, then CFIUS will conclude all action regarding a transaction.

By contrast, if CFIUS determines that the transaction poses unresolved national security concerns, it will refer the transaction to the President unless the parties abandon the transaction. The President has authority to suspend or prohibit a referred transaction. The President is mandated to decide within 15 days after the completion of CFIUS's investigation or the date CFIUS referred the transaction to the President. The President must publicly announce the decision.

Only after a detailed written analysis of the national security risk posed by the transaction will CFIUS seek mitigation measures or refer a transaction to the President. Few transactions reviewed by CFIUS are referred to the President, although 2021 was the first year since 2015 in which there was no presidential decision on a transaction reviewed by CFIUS.

Executive order focuses CFIUS review

Responding to bipartisan concern about national security implications of foreign investment in the U.S., the Order identifies economic sectors that merit special attention for review by the Committee and directs CFIUS to evaluate the impact a transaction may have on supply chain security, U.S. technology leadership, cybersecurity, and access to sensitive personal data, as well as the impact of incremental investments over time.

The Order breaks new ground by expanding from the industries on which CFIUS has historically concentrated, such as quantum computing, artificial intelligence, and semiconductors to add businesses not traditionally thought of as important to national security, such as biotechnology, critical materials, agriculture, clean energy, and climate adaptation technologies, but in which the U.S. also possesses strategic leadership.

The Committee is to consider relevant ties by the foreign buyer and its investors or other third parties "that might cause the transaction to threaten to impair the national security of the United States." The Committee's assessment is to consider incremental investment trends in a technology sector that, in the aggregate, may cede, "part-by-part," development or control of a sector or technology to a foreign person.

To the same end, the Order charges CFIUS to consider the risks that a transaction will shift control of critical supply chains to a foreign party, including to a foreign party that has "relevant third-party ties" that might cause the transaction to threaten national security. "Third-party ties" is used throughout the Order but is not defined.

CFIUS is to consider a transaction's effect on "supply chain resilience and security" within and outside the defense industrial base. The Committee is to weigh factors such as the feasibility of supply-chain diversification through alternative suppliers; whether the U.S. government itself relies on the supply chain; and the concentration of ownership or control over the supply chain by a foreign party.

The Order directs CFIUS to assess the cybersecurity capabilities of the foreign investor and cybersecurity practices of the domestic target and to weigh "sensitive data" potentially affected by the transaction. The Order notes the dangers of a transaction by a

foreign party "with the capability and intent to conduct cyber intrusions or other malicious cyber-enabled activity."

Sensitive data includes "health, digital identity, or other biological data and any data that could be identifiable or de-anonymized, that could be exploited to distinguish or trace an individual's identity in a manner that threatens national security." CFIUS is to consider whether a transaction would transfer sensitive data to a foreign investor who may exploit the information "through commercial means."

Analysis of report

With 164 Declarations and 272 Notices filed in 2021, CFIUS reviewed a record-breaking number of transactions. The number of Declarations filed increased from 126 in 2020, and 94 in 2019; the number of Notices filed grew from 187 in 2020 and 231 in 2019.

The Report covers the first full calendar year in which CFIUS operated under the regulations issued in February 2020 to implement FIRRMA. The Report's data on Declarations suggests that practitioners and the Committee are becoming more facile with the process.

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Of the 164 Declarations filed in 2021, 120 were cleared (73%); parties filing 30 Declarations were directed to file a Notice; the Committee notified parties to 12 Declarations that the Committee could not conclude action; and CFIUS rejected two Declarations. In 2020, CFIUS cleared 81 transactions based on a filed Declaration (64%) and directed parties to 28 Declarations to file a Notice.

On average, 5.48 days elapsed between submission and the date on which the Committee accepted a Declaration, which is up from 4.7 days in 2020. On average, 29.9 days were needed to complete the review of a Declaration, suggesting the Committee used the full 30-day review period for nearly all Declarations.

Declarations appear to be an increasingly attractive option for transactions involving low vulnerability on the target U.S. business from a country with a strong record of positive interaction with the Committee.

In 2021, acquirers from Canada filed the most Declarations (22); investors from Germany, Japan, South Korea, and Singapore tied for second, with each filing 11 Declarations. From 2019 to 2021, Canadian investors submitted more Declarations than any other country (54); Japanese and United Kingdom investors filed the second and third largest number of Declarations.

Unlike those countries, only one Declaration each was filed by Chinese and Russian acquirers, which suggests that Chinese and Russian investors are aware that their investments face a higher level of scrutiny by CFIUS.

Industries with the most Declarations filed include software publishers; computer systems design and related services; electric power generation, transmission, and distribution; semiconductor and other electric component manufacturing; and management of companies and enterprises.

In 2021, 272 Notices were filed with CFIUS. Of those Notices, CFIUS conducted a second 45-day investigation of 130 Notices. CFIUS concluded action after reaching mitigation agreements with the transaction parties to resolve national security concerns for 26 Notices.

If parties to a transaction do not file a Notice or Declaration, the Committee has authority to initiate unilateral review of a transaction and can request parties to submit a filing.

Two Notices were voluntarily withdrawn. Of the 272 Notices filed, 74 were withdrawn, 63 of which were refiled; this typically occurs when CFIUS notifies the parties that it is not yet in a position to approve a transaction because it needs more time to investigate the transaction or to negotiate mitigation measures or both.

In nine of these instances, the parties withdrew the Notice and abandoned the transaction after either CFIUS informed the parties it could not identify mitigation measures that would resolve its national security concerns or it proposed mitigation measures that the parties chose not to accept.

On average, the number of business days that elapsed between submission of a draft Notice and the date CFIUS provided comments was 6.2 days, which is below the 10-day deadline.

Additionally, it took about 6 days on average between submission of a formal Notice and the date on which the Committee accepted the Notice. Chinese acquirers filed the most Notices in 2021 (44), up significantly from the 17 Notices filed in 2020.

Notices involving Chinese parties are likely to present complexities, which may result in more withdrawals and refile of Notices than other countries. With 28 Notices filed in 2021, Canadian acquirers filed the second-highest number of Notices, which is more than the 11 Notices filed by Canadian acquirers in 2020. Japanese acquirers filed 26 Notices, up from 19 in 2020.

The largest number of Notices filed with CFIUS in 2021 involved foreign acquisitions of U.S. businesses in the professional, scientific, technical services, and computer/electronics product manufacturing sectors.

Germany and the United Kingdom each filed 16 Notices in those critical technology sectors and Japan filed 15, reinforcing the importance of relations between states, since those countries are not considered a high national security risk.

Mitigation measures and conditions

In 2021, CFIUS adopted mitigation measures and conditions for 31 Notices of covered transactions. Mitigation measures and conditions negotiated and adopted in 2021 required the businesses involved to take actions — such as prohibiting the transfer of certain intellectual property, trade secrets, or technical information — and establishing guidelines and terms for handling existing or future contracts with the U.S. Government or for handling other sensitive information.

Examples of other mitigation measures adopted by CFIUS in 2021 reached with transaction parties focused on protecting sensitive information. Such measures included acquirers agreeing to ensure that only authorized persons have access to certain technology systems, facilities, or sensitive information; to locate certain facilities, equipment, data, and operations in the U.S. only; to adopt security protocols to ensure the integrity of products or software sold to the U.S. Government; to exclude certain sensitive U.S. assets from the transaction; and to provide prior notification to and approval by relevant U.S. Government parties prior to any increase in ownership or other rights by the foreign acquirer.

Of the mitigation agreements and conditions entered into by the Committee, 187 are currently being monitored. In 2021, there were eight mitigation agreements terminated out of the 12 mitigation agreements materially altered. The Committee and monitoring agencies have worked to ensure compliance by the parties to the mitigation agreements.

Monitoring agencies conducted 29 site visits in 2021. CFIUS plans to continue engaging with parties to mitigation agreements or conditions to help improve compliance. CFIUS also intends to engage more actively with industry, advisors, and practitioners to encourage a culture of compliance and increase staff resources dedicated to monitoring and enforcement activities.

Transactions not involving notices

If parties to a transaction do not file a Notice or Declaration, the Committee has authority to initiate unilateral review of a transaction and can request parties to submit a filing. FIRRMA charged the Committee with increasing its review of transactions for which the parties did not initially make a filing. As a consequence, its personnel engaged in such monitoring has more than tripled since 2018.

CFIUS's methods to identify transactions without a filing include interagency referrals, tips from the public, daily review of media reports and commercial databases, and congressional notifications. The Committee identified 135 transactions through this process in 2021, but only eight resulted in a request for filing. CFIUS continues to train staff across CFIUS member agencies to boost coordination and effective identification of transactions that may require a filing.

The Department of Defense released its 43-page CFIUS procedures manual³ in December 2021, which may help demystify CFIUS's process. With more than 30 stakeholder agencies to coordinate in

conducting a CFIUS review, the manual also illustrates why CFIUS review can be time consuming.

Conclusion

CFIUS is reviewing a record number of transactions. Despite introducing mandatory filings in 2018 under FIRRMA, most CFIUS filings remain voluntary. CFIUS is proactively identifying an increasing number of potential transactions without a filing, according to the Report. Although the Committee continues to

approve most transactions without imposing mitigation conditions, President Biden's Order appears to be an effort to clarify the sometimes-mysterious review process.

Notes

¹ <https://bit.ly/3ClB9QM>

² <https://bit.ly/3y1RZBm>

³ <https://bit.ly/3Cla28l>

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