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The Evolving Role of CFIUS: Predictions for 2023

Client Advisories

Hughes Hubbard & Reed LLP • A New York Limited Liability Partnership
One Battery Park Plaza • New York, New York 10004-1482 • +1 (212) 837-6000

February 1, 2023 – Recent actions taken by the U.S. Government provide insight into the evolving role of the Committee on Foreign Investment in the United States ("CFIUS" or the "Committee"), an interagency committee authorized to review certain transactions involving foreign investment in the United States for national security risks. Specifically, CFIUS's Annual Report for Fiscal Year 2021, a new executive order from President Biden, new enforcement guidelines – along with significant growth in the number of CFIUS filings – shed light on the evolving role that inbound investment screening is playing within the U.S. Government's national security toolkit. We predict five trends related to CFIUS' activity and processes for 2023.

Background

On August 2, 2022, the U.S. Department of the Treasury, as Chair of CFIUS, released the public version of its Annual Report to Congress (the "Report"). The Report provides key indicators on CFIUS' activity in 2021, the first full year since the regulations implementing the Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA") – which expanded CFIUS' jurisdiction and enhanced its enforcement authorities – were finalized.

Further, on September 15, 2022, President Biden issued Executive Order ("EO") 14083 "on ensuring robust consideration of evolving national security risks" by CFIUS. EO 14083 elaborates on and expands the factors CFIUS should consider when determining whether transactions in its jurisdiction (i.e., covered transactions) pose an unacceptable national security risk to the United States. It is the first EO that provides presidential direction to CFIUS since its establishment in 1975. Without explicitly mentioning China, the EO emphasizes the risk that certain foreign adversaries can use the United States' policy of open investment to obtain access to sensitive data and technologies for purposes that are detrimental to U.S. national security. The EO illustrates CFIUS's evolving role within the Biden Administration's broader national security strategy, especially regarding maintaining U.S. economic and technical leadership.

Finally, on October 20, 2022, the U.S. Department of the Treasury released the first-ever CFIUS Enforcement and Penalty guidelines. (We summarized the CFIUS Enforcement and Penalty Guidelines in a previous alert.)

Enhanced Scrutiny of Transactions Involving Newly Formulated National Security Factors

As mentioned above, EO 14083 directs CFIUS to consider certain factors when evaluating national security risks posed by covered transactions. These national security factors focus on, among other things, supply chain resiliency, U.S. technological leadership, cybersecurity, and sensitive data. Thus, non-U.S. investors should anticipate an increased level of scrutiny for transactions that:

- concern U.S. businesses involved in critical U.S. supply chains that may have national security implications, including those outside the defense industrial base;
- concern U.S. businesses involved in technologies that are "fundamental" to U.S. technological leadership, including but not limited to "microelectronics, artificial intelligence, biotechnology and biomanufacturing, quantum computing, advanced clean energy, and climate adaptation technologies." (The EO also directs the White House Office of Science and Technology Policy, in consultation with other members of CFIUS, to periodically publish a list of technology sectors fundamental to U.S. technological leadership);
- could provide foreign persons or third parties the ability or opportunity to exploit cyber-related vulnerabilities in U.S. business; and
- concern U.S. businesses that have access to the sensitive data of U.S. persons, including a person's health or other biological data.

Holistic Analysis of Transactions

In addition to the factors described above, EO 14083 also directs CFIUS to consider "aggregate industry investment trends" when determining whether an individual covered transaction poses an unacceptable threat to U.S. national security. Thus, CFIUS is now directed to determine the national security risk of a covered transaction within the greater context of a series of acquisitions in the same or related U.S. businesses involving activities that are fundamental to national security. This more holistic approach is likely meant to enable CFIUS to detect patterns and risks posed by related or incremental investments and more nimbly react without the need for regulatory amendment. As a result, foreign investors should expect that CFIUS will increasingly scrutinize the entire transaction, including potentially investors' investment history, future investment plans, and market share, as well as overall economic and industrial trends involving the relevant sector, even if not specific to the transaction.

Continued Growth in CFIUS Activity

As mentioned above, in August 2022, the Department of the Treasury released a report concerning CFIUS's activity in 2021. The Report said that CFIUS reviewed a record number of transactions in 2021: 436 notices and declarations combined. It appears that the uptick in CFIUS activity is largely due to changes to CFIUS introduced by FIRRMA. In addition to expanding CFIUS's jurisdiction (i.e., the scope of covered transactions) and making the reporting of certain investments mandatory, FIRRMA also granted CFIUS enhanced authority and resources to identify and review non-notified transactions (i.e., covered transactions where the concerned parties did not declare the transaction voluntarily). The recently established Monitoring & Enforcement Office leads the Committee's efforts to identify transactions not voluntarily notified to CFIUS using a variety of methods, including interagency referrals, tips from the public, media reports, commercial databases, and congressional notifications. Rather than risk being asked by CFIUS to file a notice, which could significantly delay negotiations or even lead to the unwinding of an already executed deal, it appears that transaction parties are increasingly filing voluntary notices and declarations with CFIUS proactively. Finally, the Report indicates that CFIUS is continuing to hire staff to support all aspects of its work, including its monitoring and enforcement activities. Given its enhanced authority and additional resources, we expect that CFIUS' activity will continue to grow in 2023.

High Acceptance Rate of Transactions Including Those Involving Chinese Investments

According to the Report, China-based investors overwhelmingly opted to file notices rather than short-form declarations. Investors from China filed a total of 44 notices and 1 declaration in 2021. This was not the case for other foreign investors. Canadian investors, for instance, filed 28 notices (the second most after China) and 22 declarations in 2021. This suggests that Chinese investors anticipated their transactions would be highly scrutinized relative to transactions involving investors from other countries but would ultimately be cleared. Notably, however, the Report indicates that President Biden did not block or unwind any transactions in 2021, although out of the 436 total transactions filed with CFIUS in 2021, nine were abandoned by foreign investors because of the failure to obtain CFIUS's timely approval, likely due to foreshadowing that the transactions would be likely to be blocked. An additional 63 transactions were withdrawn but re-filed once the parties had considered CFIUS's mitigation terms (CFIUS ultimately adopted mitigation measures and conditions for 31 notices of covered transactions in 2021). The Report demonstrates the high rate of proposed transactions that CFIUS cleared without conditions and CFIUS' willingness to offer mitigation terms, when necessary, as opposed to rejecting proposed transactions – even those involving China-based investors. We expect these trends to continue in 2023.

An Outbound Investment Screening Regime (i.e., "Reverse CFIUS") May Be Coming

A new mechanism for implementing an outbound investment screening regime was originally introduced by members of Congress in the proposed National Critical Capabilities Defense Act ("NCCDA") of 2021. On June 13, 2022, a bipartisan group of U.S. lawmakers publicly circulated a revised version of the draft legislation, titled the NCCDA of 2022. The NCCDA of 2022 would create a new interagency, the Committee on National Critical Capabilities, which would be tasked with ensuring that countries of concern (e.g., China and Russia) do not use outbound investment, in the form of U.S. technology and capital, to enhance their capabilities in key industries and business sectors. The broad provisions of the current proposal have drawn significant criticism from the business community, however, and significant revisions to the draft legislation are likely. Nonetheless, the general concept of an outbound investment review mechanism continues to attract bipartisan support. We believe that either Congress or the Biden Administration, via Executive Order, could very well enact some version of the proposal in 2023.

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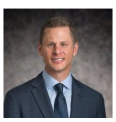

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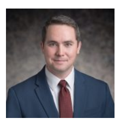

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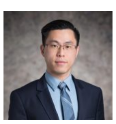

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