



Publications & News

CFIUS Actions Highlight Focus on Critical Technologies and Infrastructure

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In its latest report to Congress, the Committee on Foreign Investment in the United States (CFIUS), the US government's interagency body that vets foreign investment with national security implications, reported that it reviewed a record 147 notices in 2014, a 52% increase from 2013.¹ This data, as well as public information about more recent individual cases reviewed by CFIUS, underscores that CFIUS is taking a more expansive view of its jurisdiction and will scrutinize investments affecting US critical technologies and critical infrastructure. Parties considering transactions subject to CFIUS review should take account of this recent CFIUS precedent in conducting national security due diligence for their deals.

I. Report Highlights

The CFIUS Annual Report suggests several trends in its review of covered transactions:

- CFIUS reports a significant increase in the total number of cases filed in 2014 (147), compared with 2013 (97) and 2012 (114).
- The percentage of cases that CFIUS extended into an additional 45-day investigation period decreased, however, to 35% in 2014 from 49% in 2013. The high number of investigations in 2013 was due partly to the US government shutdown.
- Although no transaction was formally blocked in 2014, 12 notices were withdrawn during either the initial review or investigation stage. Some of these notices may have been withdrawn and not refiled as a result of CFIUS-related national security concerns, but others may have been withdrawn for unrelated commercial or regulatory reasons.
- CFIUS required mitigation in 9 cases in 2014, or 6% of all notices, a decrease from 11% of the CFIUS notices reviewed in 2013.

The report indicates a marked increase in transactions in the computer and electronic product sector (29 notices) in 2014, a 142% increase from 2013 (12 notices). As described further below, the largest number of 2014 notices occurred in the semiconductor and other electronic component manufacturing subsectors (12 notices). A significant share of notices also occurred in the professional, scientific, and technical services (14 notices) and utilities (13 notices) sectors.

Acquisitions by investors from Canada, China, Japan and the United Kingdom continued to account for the largest share of notices in 2014, with 15, 24, 10 and 21 notices, respectively. Over the 2012 to 2014 period, the top three home countries of foreign acquirers were China (68 notices), the United Kingdom (45 notices) and Canada (40 notices).

II. US Critical Technologies and Critical Infrastructure Concerns

The report and recent action by CFIUS—including publicized actions subsequent to the 2014 reporting period—suggest that CFIUS will closely scrutinize investments affecting US critical



technologies and critical infrastructure and may interpret its jurisdiction expansively in cases of doubt.

As described below, for companies contemplating transactions that may be subject to CFIUS review, transaction diligence should be comprehensive and include: both direct US government contracts held by the US business and potential indirect or channel sales to government agencies via third-party distributors (to the extent ascertainable); possible past US government grants to foster the development of the subject technology; potential defense applications for any subject technology (even those not directly known by the parties); and proximity of US facilities to military installations or other sensitive infrastructure. Such diligence will assist parties in assessing the likelihood of CFIUS approval, addressing any national security issues proactively at an early stage of review, and developing appropriate risk-sharing provisions in contract documents.

A. CFIUS's Growing Semiconductor and Defense Supply Chain Focus

CFIUS has reviewed a significant number of semiconductor deals in recent years, including 12 notices in 2014, 6 notices in 2013, and 12 notices in 2012. Over the past year, China-based investors have reportedly bid for at least 10 semiconductor businesses, most of which were in the United States.² The US Department of Defense, one of the CFIUS agencies, has also created a special task force to examine semiconductor concerns for the defense supply chain.

This does not mean that CFIUS will not allow semiconductor deals to proceed. For example, in November 2015, NXP Semiconductors N.V. announced that it received clearance on the \$1.8 billion sale of its RF Power business to Jianguang Asset Management Co. Ltd., a Chinese state-owned investment company. In November 2015, Integrated Silicon Solution Inc. received CFIUS approval for its \$640 million deal with a China-backed investment group led by Hua Capital and Summitview Capital. In October 2015, OmniVision Technologies Inc., a camera sensor-maker, and a group including Chinese investors Hua Capital Management Co., Ltd., CITIC Capital Holdings Limited and GoldStone Investment Co., Ltd., received CFIUS approval for a \$1.9 billion deal.

CFIUS concerns did apparently lead to the blocking in January 2016 of the \$2.9 billion acquisition by a Chinese consortium led by GO Scale Capital of an 80% stake in Koninklijke Philips N.V.'s California-based Lumileds business, a supplier of semiconductor light-emitting diode (LED) lighting components for general illumination, consumer electronics and automotive applications. The transaction did not appear on its face to give rise to major national security concerns in light of Lumileds' known customer base, and CFIUS did not describe the precise concerns underlying its opposition.

Reports indicate, however, that solid-state lighting, such as advanced LEDs and component materials, may have a variety of sophisticated defense applications.³ Given that CFIUS reportedly told the company that "it couldn't have been aware of the reason for its objections," it is possible that Lumileds products' comprised part of the supply chain for sensitive military technology and/or benefitted directly or indirectly from US government development grants.⁴

The failure of the Lumileds deal—for which the parties had already committed an estimated €500 million in separation costs—underscores the need for comprehensive diligence for deals subject to CFIUS jurisdiction. Although companies may not always have insight into government end users for third-party sales, understanding the sensitivity and potential military applications of products may assist parties in developing informed CFIUS assessments and appropriate risk-sharing provisions in contract documents. Also, members of Congress have raised concerns with semiconductor and other related transactions, requiring companies to be proactive and potentially engage publicly to address national security concerns.⁵

B. CFIUS Interprets Its Jurisdiction Expansively

Particularly in sectors of increased CFIUS risk, some parties have attempted to structure deals to avoid CFIUS scrutiny, but CFIUS will interpret its jurisdiction expansively in cases of

doubt. For example, Western Digital Corp., a US hard drive manufacturer, and Tsinghua Unisplendour Corp., a Chinese business, recently abandoned a \$3.8 billion deal for Tsinghua's acquisition of a 15% stake in Western Digital after CFIUS indicated that it would review the transaction.⁶ The parties had been engaged in a months-long process with CFIUS to determine whether CFIUS even had jurisdiction to review the transaction.⁷ The parties reportedly structured the transaction to avoid implicating CFIUS jurisdiction, which requires acquisition by a foreign person of "control" over a "US business."⁸ Although CFIUS has a safe harbor provision for purely passive investments,⁹ the deal would have reportedly made Tsinghua the largest Western Digital shareholder and granted Tsinghua a representative on the Western Digital board.¹⁰

C. CFIUS Scrutinizes Co-Location and Critical Infrastructure

Since CFIUS forced the divestment of an acquisition by Ralls Corporation, a US company owned by Chinese nationals, of a wind farm overlooking a US naval base in Oregon in 2012, co-location and critical infrastructure issues have become an increasingly important CFIUS review factor. In 2013, CFIUS reportedly scrutinized the acquisition of Smithfield Foods Inc., a major US pork producer, by a Chinese investor, Shuanghui International Holdings Ltd., in part over Smithfield's proximity to a variety of US military installations in Virginia.¹¹ That year, CFIUS also forced Chinese energy firm Cnooc Ltd. to divest various oil platforms and approximately 200 leases in the Gulf of Mexico due to proximity to a US naval base in Louisiana as a condition to approving its acquisition of Nexen Inc., a Canadian energy firm.¹² This year, negotiations between Terex Corp., a US construction and crane firm, and Zoomlion, a Chinese buyer, were reportedly complicated by Terex's US government contracts and operations at the Port of Long Beach, California, the second-largest US port, before Zoomlion backed out of negotiations in May.¹³

This recent CFIUS precedent suggests that parties should closely scrutinize the locations of all US offices and facilities associated with the US business of the target company. In the case of multiple US facilities, CFIUS may require security procedures, assurances or possible divestment of the assets in question.

¹ CFIUS Annual Report to Congress, CY 2014, *available at* www.treasury.gov/resource-center/international/foreign-investment/Documents/Annual%20Report%20to%20Congress%20for%20CY2014.pdf.

² Keith Bradsher and Paul Mozur, "Political Backlash Grows in Washington to Chinese Takeovers," *The New York Times*, Feb. 16, 2016.

³ See, e.g., Department of Defense, Defense Advanced Research Projects Agency, FY 2012 Budget Estimates.

⁴ Geoffrey Smith, "U.S. Kills Philips' LumiLEDs Sale And No-One Knows Why," *Fortune*, January 22, 2016.

⁵ See, e.g., Andrea Shalal, "McCain raises concerns about possible China bid for Micron Tech," *Reuters*, July 15, 2015.

⁶ David McLaughlin and Aaron Ricadela, "Western Digital Loses China Investor Over Security Review," *Bloomberg*, February 23, 2016.

⁷ David McLaughlin and Ian King, "Western Digital Clock Reset Shows Hurdles for Tsinghua Sale," *Bloomberg*, January 28, 2016.



⁸ See 31 C.F.R. §§ 800.207, 800.301.

⁹ 31 C.F.R. § 800.302(b).

¹⁰ Similarly, in 2011, CFIUS forced Huawei to divest its purchase of US technology firm 3Leaf, even though it purchased certain aspects of 3Leaf's patents and servers out of bankruptcy. Given 3Leaf's financial condition, the parties apparently expected that the deal would not be reviewable by CFIUS. Shayndi Raice, "Huawei Set Back on Deal in U.S.," *The Wall Street Journal*, Feb. 15, 2011.

¹¹ Liz Hoffman, "CFIUS Takes Closer Look At Smithfield Deal," *Law360*, July 24, 2013.

¹² Rebecca Penty and Sara Forden, "Cnooc Said to Cede Control of Nexen's U.S. Gulf Assets," *Bloomberg*, March 1, 2013.

¹³ Greg Roumeliotis and Diane Bartz, "Terex sale talks with Zoomlion continue despite worry U.S. may block: sources," *Reuters*, January 29, 2016.

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