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CFIUS: New Congress Continues Effort To Increase Scrutiny Of Foreign Investment In The U.S.

The recent *Economic Report of the President* (February 2007) (at 176–81) once again emphasized the many benefits the U.S. economy receives from foreign direct investment and expressed concern that the U.S. is becoming less attractive to foreign investors. Perhaps unintentionally underscoring this latter point, on February 28 the House of Representatives passed, 423–0, H.R. 556, which would subject certain foreign investments in the U.S. to more scrutiny. This bill demonstrates that while the furor may have abated over last year's Dubai Ports World acquisition—subsequently unwound—of U.S. assets involved in the management of various major U.S. ports, Congress has not abandoned its view that national security requires a more rigorous and transparent—some might say politicized—process for determining whether a foreign investment threatens national security and should be blocked or significantly restructured to mitigate such concerns.

The Exon-Florio Review Process—Since 1988, the president has had authority under § 721 of the Defense Production Act, 50 USCA App. § 2170 (added by the Exon-Florio Amendment to the Omnibus Trade and Competitiveness Act of 1988, P.L. 100-418), to block a foreign person's direct or indirect acquisition of a business in the U.S. if "credible evidence" exists that the foreign person may take action that threatens national security and other provisions of law do not provide adequate protection. The president's determination is not subject to judicial review.

In 1988, the president delegated this responsibility to a preexisting multiple-agency group known as the Committee on Foreign Investment in the United States (CFIUS), chaired by the secretary of the treasury. President Gerald Ford established CFIUS by Executive Order 11858 (1975) to monitor the impact of foreign investment in the U.S. Currently, CFIUS has 12 members, including representatives from the departments of the Treasury, State, Defense, Commerce and Homeland Security, the attorney general and various members of the Executive Office of the President. The Treasury Department provides the CFIUS staff.

The Exon-Florio amendment and implementing regulations, 31 CFR pt. 800, provide a four-step process for reviewing foreign investment transactions premised in part, like the Hart-Scott-Rodino Act review of mergers and acquisitions for antitrust concerns, on acknowledgement that expeditious Government review of proposed transactions promotes the financial markets' need for certainty.

Step 1 is the filing of a *voluntary* notice by one or all of the parties to a transaction that could result in a foreign person's control of a U.S. business. While this notice is not mandatory and there is no threshold under which a transaction is exempt from review, there is an incentive to file if national security issues are implicated. Any CFIUS member can submit a notice up to three years after the transaction concludes, or later in some circumstances, presenting the risk that a concluded transaction may subsequently be undone. 31 CFR § 800.401(c).

In step 2, CFIUS has 30 days to decide whether to initiate an investigation of the transaction; essentially, this means that each CFIUS member has only 23 days to comment on whether credible evidence supports the belief that the foreign interest exercising control of the U.S. entity to be acquired may take action that threatens national security. Therefore, parties contemplating transactions with foreign investors generally will work informally with CFIUS member agencies to identify and allay any particular national security concerns. For example, if a U.S. company has a facility security clearance, the parties must engage the Defense Security Service well before filing an Exon-Florio notice because it may take more than 90 days to negotiate an appropriate foreign ownership control or influence (FOCI) mitigation plan such as a Proxy Agreement or Special

Security Agreement under the National Industrial Security Program Operating Manual (NISPOM), DOD 5220.22-M (February 2006). If unanticipated issues arise during review, the practice has developed—with CFIUS' encouragement—for the parties to withdraw their notice to permit more time to resolve any issues without triggering an investigation.

In step 3, CFIUS has 45 days to conduct its investigation and report its recommendation and dissenting views to the president. The president then, in step 4, has 15 days to decide whether to permit, suspend or prohibit the transaction, including whether to take action to compel divestment of a completed acquisition.

As a practical matter, virtually all reviewed transactions are resolved within the initial 30-day review period, either through CFIUS' determination to not initiate an investigation or the company's withdrawal of the transaction. In fact, as found recently by the Government Accountability Office, from 1997 to 2004, only 8 of 451 transactions submitted to CFIUS for review resulted in investigations. *Defense Trade: Enhancements to the Implementation of Exon-Florio Could Strengthen the Law's Effectiveness* (GAO-05-686) (September 2005) at 13. Since 1988, only one case—involving the China National Aero-Technology Import and Export Co.'s acquisition of MAMCO Inc., a manufacturer of civilian aircraft components—has resulted in a formal presidential disapproval. More commonly, foreign parties simply have withdrawn the notice and abandoned the transaction when it becomes clear that approval is unlikely.

Rising Congressional Concerns about the Review Process—Over the years, transactions rarely have presented issues sensitive enough that Congress or the public questioned them. An exception occurred in the early 1990s when Thomson-CSF, then largely owned by the French government, sought to acquire LTV Aerospace. However, in a post-9/11 environment, the frequency and level of such concerns have increased as the public and Congress have expanded their definition of national security interests and, consequently, of the kinds of foreign investment transactions that should be investigated.

In early 2005, for example, congressional pressure led IBM to submit to CFIUS for review the proposed sale of its personal-computer business to the Chinese company Lenovo Group Ltd. That transaction was approved after IBM agreed to certain mitigation measures. Regarding another transaction later in 2005, Congress expressed more concerns, and some members threatened to pass legislation to block an offer from CNOOC, a Chinese company—in competition with a Chevron offer—to acquire Unocal, a domestic oil company, even though some involved assets were foreign energy resources. Many concerns stemmed from the Chinese government's significant ownership in CNOOC and fears of a likely future U.S.-Chinese competition for global energy resources. Within two months, CNOOC abandoned its bid for Unocal, blaming the "unprecedented political opposition" and "political environment" that "made it very difficult for [CNOOC] to accurately assess [its] chances of success."

Soon after, GAO published its report (cited above) criticizing various aspects of the Exon-Florio review process as implemented by CFIUS. Specifically, GAO found that some members of CFIUS, particularly those from Treasury, had an excessively narrow view of what transactions implicated national security—a view that excluded critical infrastructure, security of defense supply and preservation of U.S. technological superiority. It also criticized the practice of encouraging notice withdrawal to avoid adverse determinations. GAO recommended legislative amendments to define more clearly the factors CFIUS should consider, create a single, 75-day investigation period, and require increased CFIUS monitoring of withdrawn transactions and more detailed reporting to Congress of each transaction considered, the issues raised and the resolution.

These events were overshadowed in January 2006 when Congress learned that CFIUS decided not to investigate Dubai Ports World's acquisition of various U.S. port-operating contracts. See Hodgson and Aminian, "CFIUS: Tightening The Screws On The Foreign Investment Review Process," 3 IGC ¶ 28. The congressional response was swift and furious with 20 separate bills—many with multiple sponsors—introduced in both the House and the Senate, directed at both the Dubai Ports World transaction and the Exon-Florio review process itself. Other investors were caught in the crossfire. In March 2006, for example, one Israeli company, Check Point, withdrew its pending bid for Sourcefire, a U.S. manufacturer of devices to provide security for internal corporate networks, after CFIUS decided to initiate the investigation phase.

Ultimately, each chamber of Congress passed its own version of legislation—H.R. 5337 and S. 3549—designed to provide a more defined review process with greater congressional oversight. With the 2006 elections on the horizon, Congress had insufficient time to reconcile the bills in conference before adjourning. Though both bills proposed significant changes to the

Exon-Florio process, the Senate bill, sponsored by Sen. Richard Shelby (R-Ala.), was widely perceived to be the more onerous.

H.R. 556: the 110th Congress Resurrects the Call for "Reform"—The House wasted little time in reviving the issue in the 110th Congress. On Jan. 18, 2007, Rep. Carolyn Maloney (D-N.Y.) introduced H.R. 556, identical to the House bill in the last session. The House Committee on Financial Services held hearings February 7, and the House passed the bill with amendments, some of which addressed investment community concerns. The bill is now pending before the Senate Committee on Banking, Housing and Urban Affairs and, if enacted, would expand the scope of foreign investment transactions subject to review, modify the review process and increase congressional oversight. H.R. 556 would retain the four-step process initiated by a voluntary or member agency notice, but would dramatically tighten other aspects of the review.

1. Expanded Definition of National Security: In response to criticism that CFIUS focused solely on the traditional view of national security, H.R. 556 would expand the statutory list of factors that CFIUS must consider in each case. New factors include whether the transaction would have a "security related impact on the critical infrastructure of the United States," and whether the foreign country involved has cooperated to curtail human and drug trafficking. H.R. 556 also expands the definition of "national security" to ensure that review "shall be construed so as to include those issues relating to 'homeland security,' including its application to critical infrastructure."

Some critics are concerned about the references to critical infrastructure, which, according to Homeland Security, comprises 12 sectors—representing nearly 25 percent—of the U.S. economy, including agriculture, banking and financing, and transportation and postal/shipping. *Swinging the Pendulum Too Far: An Analysis of the CFIUS Process Post-Dubai Ports World*, NFAP Policy Brief (January 2007) at 15. Obviously, review of all foreign investment in these sectors would strain available resources, resulting in delays and even more uncertainty as to which transactions should be submitted for review.

2. Status and Authority of CFIUS: H.R. 556 would change the structure and authority of CFIUS, and make the review process more formal. First, it would establish CFIUS as a statutory body made up of the current members, with the addition of the Department of Energy. Treasury would continue as the chair, but the departments of Homeland Security and Commerce would become vice chairs. Other agencies could be invited to participate on a case-by-case basis. Perhaps most significantly, CFIUS would have the power to collect evidence under oath and require, albeit without subpoena power, witness attendance and document production. Accordingly, unlike the current process under which all information is submitted voluntarily by the parties or collected from information already known to the Government, under the new process, CFIUS could, in effect, conduct hearings on particular transactions. The parties' chief executive officers or designees would have to certify that a notice fully complies with the requirements and is "accurate and complete in all material respects."

3. Investigations: Since the failed Thomson-CSF deal and the 1992 Byrd Amendment to Exon-Florio, Congress has sought to make mandatory the investigation of transactions involving foreign government-controlled investors. Many in Congress were outraged that CFIUS did not subject Dubai Ports World—largely owned by the United Arab Emirates—to a full 45-day investigation.

On the other hand, the investment community argues that many foreign businesses with substantial foreign government ownership are operated as commercial enterprises. H.R. 556 is a compromise. As a general rule, any transaction in which the foreign interest is directly or indirectly controlled by a foreign government, referred to in the bill as a "foreign government controlled transaction," must be investigated unless the chair and vice chairs "determine ... that the transaction will not affect the national security of the United States and no agreement or condition is required to mitigate any threat to national security." For transactions not involving foreign governments, however, the bill would expressly codify CFIUS' long-time practice of adopting mitigation measures to resolve—during the initial 30-day review period—transactions that otherwise would present a potential threat to national security. The bill also would authorize extending an investigation for an additional 45-day period upon approval of two-thirds of CFIUS.

4. Withdrawals and Mitigation Monitoring: H.R. 556 would expressly codify, with conditions, some of the principal approaches CFIUS has developed under the current Exon-Florio review process. As noted above, GAO criticized the practice of permitting parties to withdraw notices to avoid an adverse decision under the statutory time limits. Under H.R. 556, a party could withdraw its notice before completing either the

review or investigation, but CFIUS would be required to establish controls.

First, CFIUS must institute interim protections to address any identified potential threats to national security. Second, it must establish a specific timetable for resubmitting the notice or abandoning the transaction. Finally, CFIUS would have to create a process for tracking withdrawn transactions to ensure resubmission. Additionally, H.R. 556 would continue to allow mitigation agreements to be negotiated with one or more of the member agencies. The agencies, however, would have to report to the chair and vice chairs every six months on the implementation. They also would have to monitor the agreements and report on post-transaction compliance with the mitigation measures.

5. Intelligence Review: Among its criticisms, GAO noted that the short time frame for transaction review marginalizes the intelligence agencies' contribution to the review. H.R. 556 would address this concern by requiring the director of national intelligence to analyze any covered transaction's potential threat to national security. As introduced, the bill required this analysis within 30 days of a notice submission, i.e., the last day of the review period. In response to investment community concerns that this could delay resolution, the bill was amended to require only that the director have "adequate time" to complete the analysis. H.R. 556 also states that the director should not be a member of CFIUS or have any policy role, but should be considered an independent advisor.

6. Congressional Oversight: H.R. 556 would significantly increase congressional oversight of the Exon-Florio review process. The bill contemplates both reports on specific transactions and more general annual reports.

Written reports of investigated transactions would be required within five days after the investigation is complete, and would go to identified congressional leadership and committees, as well as to the congressional delegation for any state affected by the transaction. These initial non-public reports must include both the findings about the factors considered and the actions taken to mitigate concerns.

Annual reports would be public and would require summaries of all reviews initiated during the year, including their status and all actions taken, mitigation agreements and withdrawals. The annual reports also must specifically address any discerned trends of foreign acquisition of critical technologies, although this portion of the report could be classified. H.R. 556 would permit any member of Congress to request that a classified briefing of any covered transaction be provided to the same congressional leaders who receive the written reports.

Where Are We Now?—It is not currently possible to predict when or how the Senate will take up the House bill. However, two things are clear. First, H.R. 556 differs in some key respects from S. 3549 (the Shelby bill), which unanimously passed the Senate last session. Second, CFIUS already has responded to congressional pressure and tightened the review process.

Perhaps the most significant differences between H.R. 556 and the Senate approach evinced by last session's Shelby bill are the level and timing of congressional oversight. The Shelby bill would have required CFIUS to report to Congress within 10 days after the initiation of a review and after each following step. These reports would go to the congressional leadership (similar to the list in H.R. 556), but, in covered transactions involving critical infrastructure, also would go to congressional delegations for the states involved and to those states' governors. This approach obviously would create political uncertainty about many transactions.

Another notable difference between H.R. 556 and the former Senate approach involves mitigation agreements. The Shelby bill would have treated those agreements as contracts and vested exclusive jurisdiction in the U.S. District Court for the District of Columbia to enforce the agreements upon application of the attorney general. Other differences include the Shelby bill's required investigation of a covered transaction presenting "any possible impairment" of critical infrastructure. To address a perceived conflict of interest with Treasury's foreign investment promoting views, the Shelby bill also would have eliminated any other Treasury responsibilities of CFIUS staff.

Whether the Senate will revive the Shelby bill approach or even act on H.R. 556 remains to be seen. CFIUS, however, has not waited. It has gotten the message and noted the political climate, and has implemented a number of informal changes to the process. Investors appear to have felt the political winds as well, as Treasury reported that 113 notices were submitted in 2006, a 73-percent increase over the prior year.

Among the changes adopted by CFIUS is the requirement that all officers and directors of the foreign party provide personal identification information. Also, higher-level officials at CFIUS member agencies participate more directly in the process, and CFIUS decisions now are communicated by the assistant secretary of the treasury for international affairs rather than by the

CFIUS staff chair, as was the practice in the past. CFIUS additionally is providing some notification to Congress after each case concludes.

Perhaps most significantly, the number, types and terms of mitigation agreements, particularly with Homeland Security, have increased dramatically. The Alcatel-Lucent deal approved by the president Nov. 17, 2006, provided a public confirmation of this trend, as Lucent's Securities and Exchange Commission Form 8-K, dated Nov. 21, 2006, revealed that it entered into a national security agreement with multiple agencies, as well as into the more common special security agreement (see NISPOM ¶ 2-303.c) with DOD. The national security agreement raised concern because it contains an "evergreen" provision allowing CFIUS to "reopen review of the merger transaction and revise any recommendations submitted to the President" should "Alcatel-Lucent parties materially fail to comply with its terms" and such failure threatens national security.

In short, whether Congress codifies a more stringent review of foreign investment in the U.S. because of national security concerns, foreign investors and their domestic targets can expect some unsettling and costly trends. CFIUS members are expanding their view of what transactions implicate national security and more aggressively seeking mitigation measures. Potential parties to such transactions must anticipate areas of concern before launching a transaction and prepare for the types of mitigation the CFIUS members are likely to seek.

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