



CONGRESS STRENGTHENS LAW TO PREVENT FOREIGN INVESTMENTS THAT COULD THREATEN NATIONAL SECURITY

INTRODUCTION

Following nearly two years of debate, Congress recently approved, and President Bush signed into law, new provisions designed to prevent foreign acquisitions of US companies that could impair the national security of the United States. Enactment of these new provisions represents the culmination of efforts to determine how to respond to situations such as the proposal of Dubai Ports World to acquire control over certain ports in the United States, which caused serious concern among Members of Congress and others about the adequacy of government measures to prevent harm to domestic security interests from certain foreign direct investments in the United States.

The new legislation, the Foreign Investment and National Security Act of 2007, amends the statute commonly known as “Exon-Florio” (named after its original sponsors, former Senator James Exon and Representative James Florio), which was adopted in 1988 as an amendment to the Defense Production Act of 1950. Exon-Florio authorizes the President to suspend or prohibit any acquisition, merger, or takeover of a “US person” by a “foreign person” that would threaten to impair the national security of the United States. Pursuant to Executive Order, the President relies on an interagency group, the Committee on Foreign Investment in the United States (“CFIUS”), to analyze the extent to which particular transactions might have such an adverse effect. Under Exon-Florio, CFIUS has specific time limits within which to complete its analysis after being notified of a transaction: 30 days for an initial review and, if that review does not rule out any foreseeable national security threat, an additional 45 days for an in-depth investigation. At the conclusion of any such in-depth 45-day investigation, CFIUS must recommend to the President whether or not to interfere with the transaction. The President then has 15 days to decide whether to follow or reject that recommendation.

WHAT HAS NOT CHANGED?

During the recent legislative debate, there were a variety of proposals for altering the CFIUS review procedures, including to extend the 30-day review and/or 45-

AUGUST 2007

Washington, DC
+1 202.942.5000

New York
+1 212.715.1000

London
+44 (0)20 7786 6100

Brussels
+32 (0)2 517 6600

Los Angeles
+1 213.243.4000

San Francisco
+1 415.356.3000

Northern Virginia
+1 703.720.7000

Denver
+1 303.863.1000

This summary is intended to be a general summary of the law and does not constitute legal advice. You should consult with competent counsel to determine applicable legal requirements in a specific fact situation.

arnoldporter.com

day investigation periods. As finally enacted, however, the amendments leave those time periods and certain other key elements of the process intact. For example:

- There is still no requirement that the parties to a transaction in which a foreign entity will gain control over a US entity (a “covered transaction”) notify CFIUS in advance of undertaking the transaction. Thus, it remains up to the parties to determine if such notification is in their best interest, taking into account that, absent a satisfactory CFIUS review prior to closing, the President has the authority to order divestiture of a covered transaction after-the-fact.
- CFIUS will still undertake an Exon-Florio review of a foreign acquisition upon notice of the deal from either (1) the parties to the transaction or (2) an agency member of CFIUS itself.
- A 45-day in-depth investigation will still be undertaken if CFIUS determines, during the initial 30-day review period, that the transaction at issue threatens to impair US national security and that threat has not been mitigated by measures agreed to during the 30-day review.

WHAT NEW PROCEDURES APPLY?

Mandatory 45-day Investigations.

Prior to the amendments’ adoption, the only cases in which a 45-day investigation was mandatory were those involving the acquisition by a foreign government of control over a US entity that could affect US national security, and CFIUS, in its discretion, could find that foreign government control would not have such an effect. Under the amended law, however, a 45-day investigation is mandatory:

- in *any* case in which a transaction will result in foreign government control over a US entity, unless both the Secretary of the Treasury and the agency selected to head up the CFIUS review of the transaction (the “lead agency”) find the transaction will not impair US national security;
- whenever a transaction would result in foreign control of any “critical infrastructure” of or within the United States,¹ where such control could impair national security and that impairment has not been mitigated during the 30-day review period; and

¹ Under the new legislation, the “critical infrastructure” means “systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems or assets would have a debilitating impact on national security.”

- whenever the lead agency recommends an investigation and the rest of CFIUS concurs.

The new legislation also formalizes and places constraints on certain procedures that have evolved as a matter of practice during the years since Exon-Florio was enacted. For example:

Withdrawal and resubmission

of a revised notice has become a relatively common means of avoiding either a 45-day investigation or, if such investigation has already commenced, an adverse CFIUS decision. Under the amended law:

- A notice to CFIUS may be withdrawn only after approval by CFIUS of a *written request* for withdrawal from the parties.
- When any notice is withdrawn, CFIUS must:
 - establish interim protections to address concerns raised with respect to the transaction at issue;
 - set a specific time frame for resubmission of the notice; and
 - track any actions taken by the parties in connection with the transaction prior to resubmission of the notice.

Mitigation agreements with CFIUS have enabled the parties to a transaction to overcome objections within CFIUS to their deal by restructuring or setting

constraints on certain aspects of the transaction. The recent amendments provide that:

- The “lead agency” is responsible for negotiating, monitoring and enforcing a mitigation agreement;
- When a mitigation agreement is entered into, the lead agency must report to CFIUS, the Director of National Intelligence, the US Attorney General and any other interested federal agency on any material modification to the agreement;
- CFIUS must establish methods for evaluating compliance with such mitigation agreements;
- In the event of any intentional, material breach of a mitigation agreement that cannot be otherwise remedied, the President or CFIUS may initiate a new Exon-Florio review of the subject transaction.

Civil Penalties. The new amendments also provide for the imposition of civil penalties for any violation of Exon-Florio, including breach of any mitigation agreement or conditions imposed on a particular transaction. CFIUS is to issue regulations regarding the imposition of such penalties.

HOW MIGHT CFIUS DECISIONS BE AFFECTED?

There are several ways in which the new legislation may influence

the outcome of CFIUS reviews, including:

New CFIUS Composition. The new amendments codify the membership of CFIUS as its current Cabinet members,² as well as the Secretary of Energy and (as non-voting, ex officio members) the Secretary of Labor and the Director of National Intelligence. The President may also appoint additional members from among the heads of any other executive department, agency, or office, either generally or on a case-by-case basis.

New Role for Director of National Intelligence. As an ex officio member of CFIUS, the Director of National Intelligence is given special responsibility to conduct a “thorough analysis” of any threat to national security posed by a foreign acquisition and must report to CFIUS on that analysis within 20 days of CFIUS’s receipt of notice of the acquisition.

New Factors for CFIUS Consideration. CFIUS will have several new factors to consider in evaluating the national security implications of a foreign acquisition. These include:

- Potential national security-related effects on US critical infrastructure, including major energy assets, and on US critical technologies;
- With respect to the foreign country where the acquirer or its parent or other controlling entity is based:
 - The country’s adherence to nonproliferation of arms regimes;
 - The country’s relationship with the United States, in particular with respect to cooperation in counter-terrorism efforts; and
 - The potential for transshipment or diversion of technologies with military applications; and
- Long-term US energy and critical resources requirements.

WILL CFIUS PROCEDURES BE MORE TRANSPARENT?

A major criticism of CFIUS and its deliberations has been that they are confidential and therefore difficult to monitor, assess, or even fully understand. The new legislation helps provide more transparency with respect to CFIUS in several ways:

Reports to Congress. Under the new legislation, CFIUS has substantially increased obligations to keep Congress informed. For example:

² The current Cabinet members of CFIUS are the Secretaries of Commerce, Defense, State, Treasury and Homeland Security, as well as the Attorney General of the United States.

- Following each 30-day review and each 45-day investigation where CFIUS does not recommend further action under Exon-Florio, CFIUS must give Congress a certified report providing details about the subject transaction.
- Each year, CFIUS must submit annual reports to Congress on all of the transactions that have been reviewed or investigated during the previous 12 months, including information on the business sectors involved and the countries from which investments originated, the extent to which notices have been withdrawn and resubmitted, the types of mitigation methods CFIUS has used, and the types of adverse national security/critical infrastructure effects that CFIUS plans to take into account during the next 12 months.

The required annual reports to Congress will be made publicly available—with the exception of any classified information—to the extent that doing so will not compromise national security and privacy.

Guidance for the Public. In addition to providing for public versions of CFIUS's required annual reports to Congress, the new legislation will enhance transparency for members of the public by requiring CFIUS to issue, by early in 2008, guidance on the types of transactions that it has reviewed that have presented national security considerations.

CONCLUSION

Overall, the practical effect of the new amendments will likely be less substantial than might have been expected during certain points in the legislative debate. The increased transparency provided for by the new legislation may work to the benefit of private parties as well as Congress. And by making CFIUS more accountable to Congress on an on-going basis, the amendments may help ward off Congressional intervention with respect to specific transactions.

If you would like more information about the new Exon-Florio legislation, please contact your Arnold & Porter attorney or:

Jeffrey Smith
+1 202.942.5115
Jeffrey.Smith@aporter.com

Ronald Lee
+1 202.942.5380
Ronald.Lee@aporter.com

Nancy Perkins
+1 202.942.5065
Nancy.Perkins@aporter.com