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Securing U.S. Strategic Assets: Does The Exon-Florio Statute Do Its Job?
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By Ronald D. Lee and Nancy L. Perkins

When it was announced in early 2006 that Dubai Ports World, a company controlled by the Government of Dubai, planned to acquire six major U.S. ports and had successfully undergone the U.S. government's national security review of the transaction, concerns about foreign ownership of U.S. assets intensified dramatically. A new wave of criticism arose, revitalizing arguments that had temporarily subsided when the China National Offshore Oil Corporation (CNOOC) (a Chinese Government-controlled company) withdrew its bid to acquire California-based Unocal Corporation in the summer of 2005. Now, it appears that there is great momentum behind proposals to adopt new means to prevent — or at least to screen — such proposed acquisitions by foreign companies, particularly foreign government-owned companies.

Specifically, both the Dubai Ports World and CNOOC incidents have prompted a variety of proposals to strengthen the President's authority to prohibit or suspend foreign acquisitions of U.S. companies that might threaten U.S. national security. The President currently enjoys such authority pursuant to the so-called Exon-Florio statute, which was enacted as an amendment to the Defense Production Act of 1950.

As revealed at a series of recent congressional hearings, a number of prominent members of Congress believe Exon-Florio is an underutilized tool that could and should be strengthened and sharpened. At issue is not only the scope of the statute itself, but also its implementation by the Committee on Foreign Investment in the United States (CFIUS), an interagency body charged with reviewing proposed foreign acquisitions of U.S. companies and recommending to the President whether the transactions should be prohibited or suspended. Some Members of Congress believe CFIUS has not been sufficiently aggressive in protecting national security, that its deliberations are too opaque and too narrowly focused, and that Congress should have more information about, and more control over, the committee. Will their criticisms lead to congressional scrutiny of individual foreign company bids for U.S. companies, above and beyond CFIUS reviews?

In light of the reaction to the proposed Dubai Ports World and CNOOC acquisitions and the current heightened concerns over terrorism and homeland security, the Exon-Florio process is already subject to closer scrutiny on Capitol Hill, and Congress is considering requiring changes in CFIUS's own legal authorities and procedures. Both foreign and U.S. companies should begin considering how to factor such potential changes into their strategic deal planning and their

tactical navigation of the CFIUS process.

Background on Exon-Florio

Exon-Florio, which was enacted in 1988 as an amendment to the Defense Production Act of 1950, authorizes the President to suspend or prohibit any acquisition, merger, or takeover of a "U.S. person" by a "foreign person" that would threaten to impair the "national security" of the United States. The President may exercise this authority if he finds "credible evidence" that "the foreign interest exercising control might take action that threatens to impair the national security" and that other provisions of law do not adequately and appropriately enable him otherwise to protect the national security in the matter. In this context, the President must consider five specific factors:

1. Domestic production needed for projected national defense requirements;
2. The capability and capacity of domestic industries to meet national defense requirements, including the availability of human resources, products, technology, materials, and other supplies and services;
3. The control of domestic industries and commercial activity by foreign citizens as it affects the capability and capacity of the United States to meet the requirements of national security;
4. The potential effects of the proposed or pending transaction on sales of military goods, equipment, or technology to any country that is:
    - Identified by the Secretary of State as a country that either supports terrorism or is a country "of concern" regarding missile proliferation or the proliferation of chemical and biological weapons; or
    - Listed on the "Nuclear Non-Proliferation Special Country List" or any successor list under the Nuclear Non-Proliferation Act of 1978; and
5. The potential effects of the proposed or pending transaction on U.S. international technological leadership in areas affecting U.S. national security.

By Executive Order, the President has delegated to CFIUS the responsibility for conducting Exon-Florio reviews. The current CFIUS membership consists of the Secretaries of Commerce, Defense, State, Treasury and Homeland Security, as well as the Attorney General, the United States Trade Representative, the Chairman of the Council of Economic Advisors, the Director of the Office of Management and Budget, the Director of the Office of Science and Technology Policy, the Assistant to the President for National Security Affairs, and the Assistant to the President for Economic Policy. The Treasury Secretary chairs the Committee, and the Department of the Treasury is responsible for promulgating Exon-Florio implementing regulations.

Exon-Florio sets forth a specific schedule for reviews of foreign acquisitions of which CFIUS receives official notice, which may either be submitted voluntarily by the parties to the acquisition or be provided by a member of CFIUS itself. (If the parties to the acquisition close the deal without first submitting a voluntary notice and receiving "clearance" for it from CFIUS, they face the possibility that the President, upon CFIUS's recommendation, could later order that the deal be terminated.) First, upon receipt of such notice, CFIUS must conduct a 30-day review of the transaction. If CFIUS concludes, at the completion of the 30-day review, that no

Presidential action is warranted, the Exon-Florio process is concluded with respect to that transaction. If, however, CFIUS is uncertain or concerned about the impact of the transaction upon national security at the end of the 30-day period, it may conduct a more extensive investigation during an additional 45-day period. CFIUS generally has discretion whether to conduct such an investigation but, pursuant to statutory amendments in 1992, in the case of an acquisition of (or merger with) a U.S. entity by an entity "controlled by or acting on behalf of" a foreign government, a 45-day investigation is mandatory unless CFIUS determines that the transaction could not "affect" the national security of the United States.

Upon completion of a 45-day investigation, CFIUS must present a report to the President that both states the Committee's findings and recommends whether the President should prohibit, suspend, or allow the investigated transaction. If the members cannot reach a unanimous recommendation, the Chairman must submit a report setting forth the members' differing views and the issues relevant to the President's ultimate decision. The President then has 15 days within which to decide whether to take action.

As soon as the President makes his decision, he must submit to Congress a report explaining the basis for his decision. Originally, such reports were required only when the President decided to interfere with a transaction; pursuant to the 1992 amendments to Exon-Florio, however, the President must provide a report on every Exon-Florio decision, whether affirmative or negative. This change was intended to "help Congress and the public develop an understanding of the policies underlying Presidential determinations and hold the President accountable for actions under the Exon-Florio amendment."

Is Something 'Broken' That Congress Should Fix?

As of December 2005, CFIUS had been notified of more than 1550 transactions pursuant to Treasury's regulations implementing Exon-Florio. Out of all the notified transactions, CFIUS has undertaken 45-day investigations of only 25. Of those 25, only one — the 1990 takeover of MAMCO Inc., a Seattle, WA, manufacturer and fabricator of metal components used in civilian aircraft, by the China National Aero-Technology Import and Export Corporation (CATIC), a company owned by the Chinese Government's Ministry of Aerospace Industry — has been disapproved by the President. Almost all the other transactions that were subject to full CFIUS investigations resulted in decisions by the President not to intervene.

To some critics, including leading members of Congress, this record reveals a failure of the Exon-Florio mechanism to serve its intended purpose. Many of these critics found further evidence for their inclusion in CFIUS' decision to "clear" the proposed Dubai Ports World acquisition of six U.S. ports without proceeding to a 45-day investigation. Others generally believe that CFIUS's exercise of its Exon-Florio mechanism adequately protects national security, and point to the ability of CFIUS to obtain contractual and other commitments from the parties to a proposed transaction as a condition of CFIUS's favorable decision on the transaction.

One of the principal objections to CFIUS's performance has been what some see as the Committee's apparently narrow focus on only certain specific indicia of the importance of a U.S. business to the national security. Senator James Inhofe (R-OK), for example, believes that U.S.

economic and energy security, in addition to defense security, are properly understood to be part of U.S. "national security."

Other objections focus on the confidential, Executive Branch-only nature of CFIUS decision-making. Senator Inhofe and others believe there is a lack of transparency with respect to CFIUS's deliberations that hampers Congress from ensuring that the Executive Branch is discharging its responsibilities under Exon-Florio in a thorough and responsible manner.

These concerns and others led to a request by Senate Banking Committee Chairman Richard Shelby (R-AL) and Ranking Committee Member Paul Sarbanes (D-MD) for an investigation by the Government Accountability Office (GAO) into CFIUS's performance. Among the key findings of the GAO in its report of that investigation, issued in September 2005, was that Treasury and some other agency members of CFIUS narrowly define a threat to "national security" as risks associated with export-controlled technologies, classified contracts, and specific derogatory intelligence with respect to a foreign acquiring company. The GAO concluded that other CFIUS members believe this definition is too inflexible to ensure protection of critical infrastructure, defense supply, and defense technological superiority. The GAO also found that CFIUS is reluctant to initiate 45-day investigations because of a perception that they would discourage foreign investment, contrary to U.S. open investment policy. However, the GAO concluded that the 30-day initial review period is sometimes too short for all the CFIUS member agencies to reach a decision. In these cases, CFIUS generally encourages the parties to withdraw their notification (so as to avoid a 45-day investigation) and refile it to start a new 30-day initial review. But once notices are withdrawn, they are not always refiled, and the transaction sometimes proceeds without further CFIUS review. Also, according to the GAO, because only transactions that undergo 45-day investigations lead to reports to Congress, the low number of investigations heightens the opaque nature of the CFIUS process.

Based on these findings and its analysis of them, the GAO reached the following conclusions:

- Congress should consider amending Exon-Florio to more clearly emphasize the factors that should be considered in determining potential harm to national security.
- To provide additional time for analyzing transactions when necessary, while avoiding the perceived negative connotation of investigation on foreign investment in the United States, Congress should consider combining the 30-day review and 45-day investigation into a single 75-day review period.
- With respect to CFIUS's practice of encouraging companies to withdraw their notifications of potentially problematic acquisitions and refile them later, Congress should consider requiring the CFIUS Chair to: 1) establish interim protections where specific concerns have been raised; 2) specify time-frames for refilling; and 3) establish a process for tracking any actions being taken during the withdrawal period.
- To provide more transparency and facilitate congressional oversight, Congress should revisit the criterion for reporting circumstances surrounding cases to the Congress.

The Congressional Reaction

Both before and after publication of the GAO report, certain members of Congress pressed hard for Exon-Florio amendments. These efforts were encouraged by the U.S.-China Economic and Security Review Commission, a congressionally created body that had recommended several changes to CFIUS in 2004, and reiterated that call when CNOOC made its offer to acquire Unocal. The House response was to pass a provision barring the Treasury Department from using any appropriated funds to recommend approval of the CNOOC acquisition. In the Senate, the proposals were broader, including legislation offered by Senators Inhofe and Shelby that would, among other things:

- Lengthen CFIUS's initial 30-day review period to 60 days;
- Require CFIUS to consider "long-term projections of U.S. requirements for sources of energy and other critical resources and materials and for economic security";
- Allow the Chair of either the Senate Banking Committee or the House Financial Services Committee to require a 45-day investigation of any transaction;
- Require CFIUS to report to Congress as well as the President on the findings of any 45-day investigation; and
- Allow Congress to block a transaction to which CFIUS has no objection.

With these proposals pending and adverse publicity increasing, CNOOC, obviously under substantial pressure, withdrew its bid for Unocal in early August 2005. Although that withdrawal stemmed the political tide to a degree, when the GAO released its report soon thereafter, Senator Inhofe renewed his efforts by reintroducing his proposal as the Foreign Investment Security Act of 2005 (S. 1797). Following hearings in the Senate Banking Committee on the issue, both Senators Inhofe and Shelby attempted to include their similar proposals in the National Defense Authorization Act of Fiscal Year 2006 (S. 1042). Although those efforts were unsuccessful (except with respect to a narrow provision that requires the President to examine CFIUS's procedures), the Dubai Ports World bid brought a new wave of proposed legislation. Among the various types of proposals offered are ones that would require CFIUS to consider the impact of proposed foreign acquisitions on "critical industries" in the United States or on homeland security; add the Director of National Intelligence as a new member of CFIUS and require a review of proposed foreign acquisitions by a new Subcommittee on Intelligence within CFIUS; or require a national security review and in some cases a national security investigation of proposed foreign acquisitions.

What would statutory changes such as these mean in practice? Would they discourage foreign bids and/or lessen the value of U.S. companies in the eyes of potential foreign acquirers? If Congress had authority to veto particular transactions, it seems quite likely that at least some foreign companies would take the experiences of CNOOC and Dubai Ports World as a lesson against any attempted investment in strategic areas — to the extent, of course, that potential investors are able to discern in advance which areas Congress will view as strategic. Likewise, a lengthened CFIUS review process, while relieving companies of the need to withdraw their notices in order to avoid 45-day investigations, could be discouraging to some bidders, and of course would not eliminate the possibility that companies might still face a decision about withdrawing their notices at the end of an longer, 75-day period if CFIUS's work is not complete

at that time. One possible compromise approach that would be consistent with the GAO's recommendations would be to combine the 30-day review and 45-day investigation periods, but also require CFIUS to consider and decide, within 30 days of receipt of notice of a transaction, whether the transaction so clearly raises no national security concerns that it should be approved without further consideration. That would enable CFIUS to avoid unnecessarily discouraging or delaying foreign investment with respect to "plain vanilla" transactions of which it has received notice from the parties largely as a prudential matter.

Congress, of course, has the constitutional authority to regulate commerce with foreign nations and to make all laws necessary and proper for executing this power. The Constitution, on the other hand, vests the executive power in the President. With respect to proposals to allow Congress to require 45-day investigations of specific proposed transactions that CFIUS would not otherwise undertake, or to allow congressional vetoes of a CFIUS decision to allow a foreign acquisition to proceed, involving Congress in decisions on specific transactions may upset the delicate working relationship between the Congress and the President.

Conclusion

As the Dubai Ports World and CNOOC bids demonstrate, the politics surrounding any particular transaction can have a strong influence even without an automatic right of congressional review. To inject additional political factors into the CFIUS review process as a routine matter could complicate U.S. relations with foreign countries and could seriously discourage foreign companies from attempting to pursue an investment that raises strategic issues, but might be susceptible to restructuring, refinement, or certain commitments that could be negotiated with CFIUS.

While the outcome of current legislative proposals to amend Exon-Florio and CFIUS's procedures cannot be predicted, principals in foreign bids to acquire U.S. companies and their advisers should prepare for the realities of revived congressional activity on Exon-Florio during this year and beyond. Both in dealing with congressional interest in their specific transaction and in responding to congressional proposals to amend the statute or otherwise alter CFIUS's procedures, foreign and U.S. companies urging CFIUS to allow the transaction to proceed — as well as those who may seek a CFIUS recommendation to prohibit or suspend the deal — need to consider the full range of potential national security issues, as well as "economic" and "energy" security, in evaluating a foreign acquisition. Gone, perhaps forever, are the days when advisers could assume that CFIUS or its congressional overseers would focus solely on whether the deal involves the performance of U.S. classified contracts or access to technologies subject to U.S. export controls. Participants in virtually any foreign acquisition of a U.S. company with assets of some strategic or homeland security value must be prepared to marshal arguments in favor of their deal that will serve to satisfy the concerns not only of the member agencies of CFIUS, but of the U.S. Congress as well.

***Ronald D. Lee**, a partner at Arnold & Porter LLP in Washington, DC, and a member of this newsletter's Board of Editors, practices in the national security, cybersecurity, and technology law and policy areas. As Associate Deputy Attorney General in the U.S. Department of Justice from 1998 to 2000, Mr. Lee led the Department of Justice's review of transactions notified to the*

Committee on Foreign Investment in the United States. He also served as the General Counsel of the U.S. National Security Agency from 1994 to 1998, and as Chief of Staff to the Director of Central Intelligence in 1996. ***Nancy L. Perkin****s, counsel at Arnold & Porter LLP, has assisted numerous clients in Exon-Florio proceedings and related national security matters. Her practice includes both litigation and regulatory counseling on international investment issues as well as data security. Ms. Perkins is the Chair of the International Law Section of the D.C. Bar and the Treasurer of the American Society of International Law, as well as a member of the Editorial Advisory Committee of the Society's publication "International Legal Materials."*