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The National Security Guard Dog Gets a Few More Teeth: What the New Foreign Investment Security Act of 2007 Means for Foreign Acquisitions of U.S. Companies

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On October 24, 2007, new legislation takes effect that raises the bar for foreign-owned companies, particularly companies that are subject to foreign government control, to proceed with an acquisition of a U.S. business whose activities are deemed relevant to U.S. national security. The new Foreign Investment and National Security Act of 2007 ("FINSA"),[1] which amends the statute commonly known as "Exon-Florio,"[2] is designed to tighten the scrutiny of such foreign acquisitions and to prevent them from occurring if they would impair the national security of the United States. Under FINSA, the Administration is subject to new mandates with respect to its implementation of Exon-Florio, and Congress will play a substantially greater oversight role to ensure proper implementation. These changes reflect Congress's view that, in a post-9/11 world, the executive branch must have more explicit statutory mandates to monitor and respond to foreign investment in the United States than was deemed necessary when Exon-Florio was originally enacted in 1988.

A principal trigger for enacting FINSA were several highly controversial proposed foreign acquisitions, including the 2005 bid of the China National Offshore Oil Corporation, a Chinese government-controlled company, to acquire Unocal Corporation, an oil and gas production company, and the proposal by Dubai Ports World, a company controlled by the government of Dubai, to

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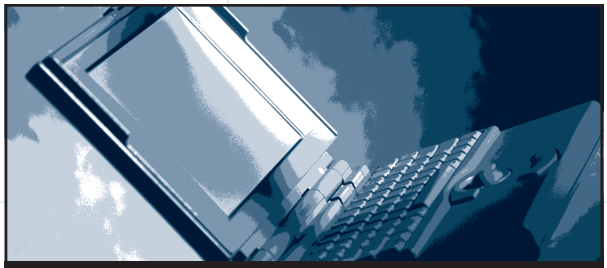

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acquire control over certain ports in the United States. When in early 2006 it was announced that Dubai Ports World's proposed acquisition had successfully undergone Exon-Florio review by the Administration, concerns about foreign ownership of security-sensitive U.S. assets intensified dramatically. At that point, the momentum surged for strengthening the basis for government review and, where necessary, prohibition of proposed foreign takeovers of U.S. companies. FINSA represents a compromise of objectives in that regard, reflecting a balancing of the benefits of foreign investment (both for the U.S. economy and U.S. interests abroad) and the potential risks that foreign control over U.S. assets may pose to the national security.

Background on Exon-Florio

Exon-Florio grants the President of the United States the authority to suspend or prohibit any acquisition, merger or takeover of a person engaged in U.S. interstate commerce by a "foreign person" that would threaten to impair the "national security" of the United States.[3] 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.[4]

Pursuant to an Executive Order issued in 1988,[5] the President has relied on an interagency group, the Committee on Foreign Investments in the United States ("CFIUS"), to analyze particular transactions and to recommend appropriate action. Notably, the parties to a transaction covered by Exon-Florio (a "covered transaction")[6] are not required to notify CFIUS of the deal prior to closing. However, because the President has the authority to interfere with a transaction even after its closing, the parties generally have an interest in providing such notification if it appears that their transaction may raise national security concerns.

Exon-Florio imposes on CFIUS specific time limits within which to complete its analysis after being notified of a transaction. 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, which may last no longer than an additional 45 days. To date, CFIUS has had quite broad discretion whether to conduct such an investigation, based on its assessment of whether the transaction could "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 permit the covered transaction. The President then has 15 days within which to decide whether to take any action, which may include ordering divestiture of the transaction if it has already taken place. Hence, parties to a proposed transaction that is notified to CFIUS generally will wait until they receive the Committee's assurance that there is no chance of adverse action under Exon-Florio before closing their transaction.

As of July 26, 2007, when FINSA was enacted, CFIUS had been notified of more than 1,700 covered transactions since Exon-Florio's enactment in 1988. Out of all of the notified transactions, CFIUS had undertaken 45-day investigations of less than 30, and the President had only once exercised his authority to disapprove a transaction.[7] Almost all of the other transactions that were subject to full CFIUS investigations resulted in decisions by the President not to intervene. Approximately half of the notifications that led to CFIUS investigations were withdrawn before completion of the 45-day period; at least one of those subsequently was restructured and cleared by CFIUS without further investigation. For many members of Congress, the sparse record of 45-day investigations and Presidential action under Exon-Florio proved a key motivation for passage of FINSA. In addition, because the bare statistics of the Exon-Florio experience do not provide any insights on the negotiations, processes, and agreements between the parties and the member agencies of CFIUS,[8] Congress also sought increased transparency with respect to Exon-Florio proceedings.

FINSA Changes

Party Notices Submitted to CFIUS

One of the key aspects of Exon-Florio that FINSA does *not* change is the voluntary nature of notifying CFIUS of a covered transaction. Thus, the parties to a covered transaction still must determine whether to submit an Exon-Florio notice, taking into consideration the likely level of concern that CFIUS, lawmakers, participants in the financial markets and others might have over any national security-related aspects of the deal. In this regard, the FINSA provides for what may prove to be meaningful guidance for the private sector: it requires CFIUS, by January 2008, to publish a description of the types of transactions that the Committee has reviewed and that have presented national security considerations, including transactions that would result in control of "critical infrastructure"[9] by a foreign government or an entity controlled by or acting on behalf of a foreign government.

FINSA also does not change the time periods for CFIUS proceedings and for Presidential action under Exon-Florio. During the debate over the legislation, it was pointed out that CFIUS had often been unable to reach a decision on whether a transaction should be permitted to proceed within the initial 30-day review period. If CFIUS had not decided favorably for the parties to a transaction during the initial 30-day period, the parties would typically withdraw their notice and, generally, resubmit it thereafter in order to benefit from a new 30-day review rather than face an in-depth, 45-day investigation culminating in a report to the President. Given this experience, some members of Congress proposed extending the initial 30-day review period. Although those proposals ultimately were rejected, Congress did include in the FINSA provisions to regulate the withdrawal and resubmission of Exon-Florio notices.

Under the amended law, the parties to a notice may withdraw it only if they submit a *written* request to CFIUS to do so and the request is granted. If the notice is withdrawn, CFIUS must set a specific time frame for any resubmission of the notice. In addition, in the interim, CFIUS must track any actions taken by the parties in connection with the transaction. The formalization of this process may make the parties to a proposed acquisition more wary of submitting Exon-Florio notices without ample confidence that their transactions will be deemed satisfactory, and could encourage more pre-filing consultations with CFIUS to determine if this confidence can be achieved and to take whatever steps may be necessary to facilitate a positive outcome.

Mitigation Agreements

Another practice addressed by FINSA that has become quite common during CFIUS reviews is the establishment of agreements designed to mitigate concerns among the CFIUS members about certain aspects of a particular transaction. Typically, these agreements provide for some restructuring of the transaction as originally proposed or for setting constraints on the control exercised by the foreign acquiring party. In cases where CFIUS requires such agreements, they are negotiated and signed before CFIUS clears the proposed acquisition. Under FINSA, such "mitigation agreements" are to be negotiated under the auspices of a particular agency member of CFIUS that is designated by the Secretary of the Treasury (who acts as the Chair of CFIUS) as the "lead agency" for the particular transaction at issue. The lead agency is responsible for negotiating, monitoring and enforcing a mitigation agreement, and must report to CFIUS, the Director of National Intelligence, the U.S. Attorney General and any other interested federal agency on any material modification to the agreement. In addition, CFIUS must establish methods for evaluating compliance with mitigation agreements on an ongoing basis. In the event of any intentional, material breach of such an agreement that cannot be otherwise remedied, either CFIUS or the President may initiate a new Exon-Florio review of the subject transaction. Notably, FINSA requires CFIUS to issue regulations providing for the imposition of civil penalties for any violation of Exon-Florio, including any breach of a mitigation agreement or failure to comply with conditions imposed on a particular transaction.

New Investigatory Mandates

Prior to FINSA's enactment, the only cases in which a 45-day investigation was mandatory were those involving the acquisition by a foreign government of control over a U.S. entity that could affect

U.S. 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 U.S. entity, unless both the Secretary of the Treasury and the lead agency for the transaction under review find that the transaction will not impair U.S. national security;
- whenever a transaction would result in foreign control of any "critical infrastructure" of or within the United States, where such control could impair national security and that impairment has not been mitigated during the 30-day review period; and
- whenever the lead agency recommends an investigation and the rest of CFIUS concurs.

Although FINSA still leaves to CFIUS the discretion to decline to undertake a 45-day investigation for transactions within the "mandatory" investigation parameters (by making the requisite statutory determinations), it is fair to assume that CFIUS will now be considerably more likely to pursue such investigations where a foreign government entity—or an entity controlled by or acting on behalf of a foreign government—is involved.

Other New Factors for CFIUS Consideration

Prior to FINSA's enactment, Exon-Florio required the President (and thus CFIUS) to consider five specific factors in reviewing a covered transaction:

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 either a) 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 b) 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.[10]

FINSA specifies that CFIUS and the President consider an additional set of factors, including:

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

New CFIUS Composition and Role of Director of National Intelligence

FINSA also may affect the outcome of Exon-Florio proceedings by virtue of its changes to the membership of CFIUS. Prior to FINSA, the members of CFIUS included 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. Under FINSA, CFIUS now consists of the Cabinet officials already on the Committee, as well as the Secretary of

Energy and (as nonvoting, *ex officio* members) the Secretary of Labor and the Director of National Intelligence ("DNI"). 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.

FINSA also creates a new role for the DNI. The DNI is a Cabinet member whose position was created by the Intelligence Reform and Terrorism Prevention Act of 2004. Reflecting the heightened focus on national intelligence following 9/11, FINSA gives the DNI special responsibilities as an *ex officio* member of CFIUS. In particular, the DNI must conduct a "thorough analysis" of any threat to national security posed by a covered transaction and must report to CFIUS on that analysis within 20 days of CFIUS's receipt of notice of the transaction. This tight 20-day deadline provides a further reason why the parties are likely to consult informally with CFIUS about a proposed transaction before formally notifying it to CFIUS.

Congressional Oversight

As noted, a major factor driving the enactment of FINSA was Congressional concern that the Administration was too lax in its implementation of Exon-Florio. Some members of Congress were frustrated by what they perceived to be passivity on the part of CFIUS with respect to Exon-Florio reviews and by the inability to ascertain what might actually be occurring within CFIUS due to the confidentiality of Exon-Florio proceedings. In response, Congress included a variety of provisions in FINSA aimed at making the proceedings more transparent -- both to Congress and the public. Under these provisions:

- 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 a report 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 that 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 or proprietary information[11]—to the extent that doing so will not compromise national security and privacy. Those reports, together with the above-referenced guidance that CFIUS must provide on the types of transactions that it has reviewed that have presented national security considerations, will likely enhance visibility into Exon-Florio proceedings and thereby facilitate planning by parties to covered transactions. Whether the guidance and reports will either increase the predictability of CFIUS outcomes or decrease the political scrutiny given to CFIUS determinations in particular cases remains to be seen.

Conclusion

In practical terms, FINSA will likely have a less dramatic effect on parties with an acquisition subject to CFIUS's jurisdiction than the legislation that the most ardent critics of CFIUS would have preferred. The increased transparency provided for by the new legislation should work to the benefit of private parties as well as Congress. And by making CFIUS more accountable to Congress on an ongoing basis, the amendments may help ward off efforts by Congress to intervene in specific transactions. The plainly prudent course for parties to covered transactions is to deal with CFIUS, a strengthened sentry, with care, early focus and sustained attention.

NOTES

1. Pub. L. No. 110-49, 121 Stat. 246 (2007).
2. Pub. L. No. 100-418, § 5021, 102 Stat. 1107, 1425 (1988) (codified at 50 U.S.C. app. § 2170) (amending the Defense Production Act of 1950). "Exon-Florio" is known as such based on the names of its original sponsors, former Senator James Exon and former Representative James Florio.
3. 50 U.S.C. app. § 2170(d).
4. *Id.* § 2170(e).

5. Executive Order No. 12661 (Dec. 27, 1988).
6. FINSA explicitly defines a "covered transaction" as "any merger, acquisition, or takeover that is proposed or pending after August 23, 1988, by or with any foreign person which could result in foreign control of any person engaged in interstate commerce in the United States." FINSA § 2 (to be codified at 50 U.S.C. app. § 2170(a)(3)).
7. That single disapproval came on February 2, 1990, when President Bush ordered the divestiture by the China National Aero-Technology Import and Export Corporation ("CATIC"), a company owned by the Chinese Government's Ministry of Aerospace Industry, of its recently acquired interest in MAMCO Inc., a Seattle, Washington manufacturer and fabricator of metal components used in civilian aircraft. Although the President provided no detailed explanation of his order, citing confidentiality concerns, according to Administration officials he was influenced in his decision by the Department of Defense and U.S. intelligence agencies, which had expressed fears that CATIC might be seeking through MAMCO to obtain technology that is restricted for export or might be put to military use.
8. Ronald Lee, "The Dog Doesn't Bark: CFIUS, the National Security Guard Dog With Teeth," *The M&A Lawyer*, Vol. 8, No. 8 (Feb. 2005), discusses the authorities, procedures, and practices of the Committee on Foreign Investment in the United States prior to their amendment by FINSA.
9. FINSA defines "critical infrastructure" as "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." FINSA § 2 (to be codified at 50 U.S.C. app. § 2170(a)(6)).
10. The latter two factors (4 and 5) were added as part of the 1992 amendments to Exon-Florio.
11. Under Exon-Florio, any information filed with CFIUS is exempt from disclosure under the Freedom of Information Act ("FOIA") and may not be made public except as relevant to an administrative or judicial action or proceeding. 50 U.S.C. app. § 2170(c).

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