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CFIUS Reform Brings More Transparency To The Foreign Investment Review Process

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On July 26, 2007, President Bush signed the Foreign Investment and National Security Act of 2007 (the "Act"), which became Public Law No. 110-049. This legislation arises out of the political debacle that resulted from the Committee on Foreign Investment in the United States' decision to allow Dubai Ports World, a firm owned by the United Arab Emirates, to acquire the operating rights to six U.S. ports. Congress has spent the last year and a half struggling with the proper level of government control of certain foreign investment. On the whole, the new legislation, which will go into effect on October 24, 2007, codifies existing practice and does relatively little damage to the open foreign investment environment of the United States.

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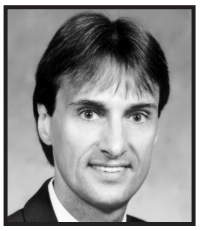

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I. The Current Review Process

Currently, Section 721 of the Defense Production Act of 1950, 5 U.S.C. App. § 2170 (2006), commonly referred to as the "Exon-Florio Amendment" or "Exon-Florio," authorizes the president to suspend or prohibit a foreign company from acquiring control over a U.S. company if such acquisition would impair "national security." Exon-Florio was enacted in order to prevent unacceptable foreign investment which was not being reviewed by any other agency of the U.S. Government. At the time of passage, there was a concern that while the Department of Defense had a mechanism for reviewing foreign investment in security-cleared U.S. defense contractors (largely through the Foreign Ownership, Control, or Influence ("FOCI") process), certain other industries did not have sufficient oversight.

Exon-Florio institutes a review regime for foreign investment in U.S. companies that are operating in the defense field (in parallel with the FOCI process), but also for technology and telecommunications companies not engaged in classified government work. This review requirement aims at strategic industries in an attempt to prevent foreign control over a U.S. entity involved in any industry relating to U.S. national security. The term "national security" was intentionally left undefined and is construed broadly by the U.S. Government.

Exon-Florio notifications are reviewed by CFIUS, an interagency committee comprised of various U.S. government agencies including the Departments of Defense, Justice, Treasury, Homeland Security, and Commerce. While submission of a notice is voluntary, because the president has authority to order divestiture, notice is usually given if the transaction meets the broad regulatory criteria set forth in 31 C.F.R. Part 800. CFIUS can also investigate on its own accord, and has, *sua sponte,* considered transactions brought to its attention by one of its member agencies, the press, or other sources.

II. The New Legislation

A review of the new legislation confirms that the Act maintains a balance between national security and the promotion of foreign investment. The real change has come over the last year and a half through CFIUS practice, which the Act has now codified. Compared with proposals introduced immediately after the DP World fiasco, the legislation which came out of the political process is fair and balanced.

a. Codifying existing practice. The Act creates a statutory basis for the establishment of CFIUS, which was initially created under Executive Order. It preserves the 30-day initial review and the 45-day investigation periods. Many of the provisions codify existing practices, such as the establishing of a procedure for withdrawals and re-submission of notifications, as well as execut-

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ing mitigating agreements between the parties to the transaction and the agency overseeing the targeted industry (*i.e.*, the lead agency). Additionally, the role of the intelligence community in the review process has been formalized by requiring the Director of National Intelligence to submit an analysis of the impact of a proposed transaction on national security.

b. Heightened political accountability. Some of the new provisions generated heated discussions during Congress's deliberations and among industry. However, the overall structure of the legislation suggests that those were included mostly for political reasons, with little impact on CFIUS powers under the existing law. For example, the new definitional section introducing terms such as "foreign government-controlled transactions" and "critical infrastructure," and the emphasis on terrorism in additional factors for consideration, do not add significantly to the broad discretion CFIUS and the president presently have.

The 1992 amendment to the Exon-Florio already provides for mandatory investigations every time a foreign government may acquire control over a U.S. business, if such a transaction "could affect national security." The new legislation simply reshuffles the existing procedure by allowing for an exception from the mandatory investigation if the Secretary of Treasury and the head of the lead agency jointly determine during the initial review that such a transaction "will not impair national security."

Similarly, the Act requires an investigation if the committee determines during the initial review that (i) a foreign acquisition of *critical infrastructure* "could impair national security," and (ii) such impairment was not mitigated during the review period, unless the Secretary of the Treasury and the head of the lead agency jointly determine that the transaction "will not impair national security." *Critical infrastructure* is defined as systems and assets which are "so vital to the U.S. that their incapacity or destruction would have a debilitating impact on national security." As with the term "national security," the definition of *critical infrastructure* emphasizes CFIUS broad discretion.

To ensure political accountability, under the new legislation the authority to make such determinations with respect to foreign government acquisitions and control over critical infrastructure may not be delegated to any person other than the Deputy Secretary or head of an agency. The Act also mandates the political appointment of an Assistant Secretary of the Treasury, who will oversee CFIUS.

c. Lead agency. The legislation provides for the designation of a lead agency among CFIUS member agencies for each transaction. The lead agency will be responsible for negotiating mitigation agreements and monitoring their implementation. Violation of such agreements, or any other provisions of the Act, will allow CFIUS to impose civil penalties under new regulations which are expected to be issued under the Act.

d. Evergreen provisions. The Act gives CFIUS the right to re-examine an approved transaction where the committee finds that the parties submitted false or misleading information, or omitted material facts during the review process; or if a party intentionally breaches a mitigation agreement and the Committee determines that there is no alternative remedy.

e. Congressional oversight. In an attempt to provide greater oversight, Congress demanded to be notified of each transaction, but only after CFIUS has concluded its review, and subject to confidentiality provisions intended to protect the parties' proprietary information. In light of the heightened political accountability, such notification must be certified by the Chairperson of the Committee on Foreign Investment and the head of the lead agency. Other types of congressional oversight include annual reporting on investment trends with respect to types of investments, investors' nationality, targeted sectors of the U.S. industry, and practices adopted by foreign acquirers.

III. Promoting A Transparent Investment Climate

The United States has a long-held policy to encourage foreign investment. Even though the government has heightened its scrutiny in reviewing foreign acquisitions after 9/11, it has maintained a relatively open investment environment.The political debacle following the DP World acquisition brought to light the fact that Congress and the public were generally not familiar with the methodology and the results of the CFIUS review process, and therefore felt the need to improve the process. Many bills were introduced both in the House and in the Senate over the past year and a half, attempting to "fix" the problem. Many of those were met by the fierce opposition from the industry, as they were proposing extended investigations, more direct participation by Congress, and in some cases, a much more circumscribed investment environment.

The political outcry that caused DP World to voluntarily divest its interest in the six U.S. ports created considerable uncertainty among investors, and political pressure on the Committee. As a result, there was a substantial increase in the number of voluntary notices filed. While CFIUS reviewed only 65 transactions in 2005, it received 113 voluntary notices in 2006, and expects to receive 150 this year. In addition, more of the transactions reach the second stage, 45-day investigation, and the number of cases in which a mitigation agreement has been required has grown rapidly.

Furthermore, the DP World episode caused investment from the UAE alone to fall by over $1 billion in 2006, according to the Department of Commerce. More generally, greater than fifty percent of the foreign direct investment from members of the Gulf Co-operation Council – Qatar, Bahrain, Saudi Arabia, the UAE, Kuwait, and Oman – has been in Europe, according to the International Institute of Finance. This evidences a significant shift from the United States.

In that investment context, the new Act comes at the right time – not too soon, to allow a cooling off period; and not too late, to prevent a permanent loss of legitimate foreign investment. One of the great achievements of the Act is providing investors with more transparency regarding the review process. Many of the changes in the Act codify practices that the Committee has developed under its statutory discretion. Some of these practices represent the committee's long-standing position, and some reflect more recent changes that arose since DP World.

In conclusion, enacting this new legislation does not radically change the CFIUS procedure. While it does provide transparency with respect to CFIUS practice, the key issue remains the strategic nature of the investment target. Investors need to be conscious of the fact that, post-9/11 and DP World, the U.S. Government has raised the level of scrutiny of foreign investment in the United States. However, the Act evidences government concern that the U.S. investment environment must remain as open as possible. On this one, the delay in congressional action has been critical in not allowing the heat of the moment to result in bad legislation.