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New CFIUS Reform Act Presents Challenges To Foreign Investment In The United States

Edward L. Rubinoff
and Henry A. Terhune

AKIN GUMP STRAUSS HAUER &
FELD LLP

The U.S. Congress has overwhelmingly passed the Foreign Investment and National Security Act of 2007 (FINSA), which fundamentally alters the process by which the Committee on Foreign Investment in the United States (CFIUS) reviews and clears proposed acquisitions of U.S. businesses by foreign persons under the so-called Exon-Florio law. CFIUS reform legislation was prompted by several high-profile transactions that raised considerable public and political controversy in 2005 and 2006, and concerns that some Members of Congress had regarding the sufficiency of the CFIUS process then in place. The FINSA bill, which is expected to be signed into law by President Bush very soon, expands the scope of foreign investment transactions that are subject to national security reviews, mandates second-stage investigations of transactions involving U.S. critical infrastructure and state-owned or -controlled foreign entities, requires CFIUS to enter into and enforce agreements with foreign buyers to mitigate national security concerns, and increases congressional oversight of CFIUS proceedings.

In summary, these changes will expose more transactions to this revised national security review procedure, impose additional requirements on the parties engaged in this process, and increase the level of congressional and public attention to transactions that are subject to Exon-Florio. This will necessarily increase the complexity of a CFIUS proceeding, as well as demand that parties navigating it employ more sophisticated and coordinated strategies to anticipate and deal with the full range of regulatory, policy and political issues that can be expected to arise. This article summarizes the major provisions of FINSA and discusses the implications for non-U.S. persons and entities contemplating acquisitions of U.S. businesses.

Background On Exon-Florio

Originally enacted in 1998, the Exon-Florio amendment to the Defense Production Act authorizes the President to block a transaction (or order divestment of a completed transaction) whereby a foreign person gains control over a U.S. business if there is credible evidence that such foreign control of the U.S. entity "threatens to impair the national security" of the United States and existing provisions of law do not provide adequate authority to protect the national security. The interagency CFIUS committee was established to conduct the reviews and investigations required under the Exon-Florio amendment and make recommendations to the President. Although notifying CFIUS of a proposed foreign investment transaction is voluntary, many parties nevertheless seek CFIUS clearance in order to eliminate the otherwise unextinguished potential liability under the Exon-Florio law.

Edward L. Rubinoff, P.C., focuses on international trade policy and regulation and heads the firm's export control and economic sanctions practice. Henry A. Terhune advises clients on public policy matters. Both are Partners in Akin Gump's Washington, DC office.

Summary Of FINSA Provisions

CFIUS Organization. FINSA provides a statutory basis for CFIUS, confirms the Secretary of the Treasury as the Chairperson of CFIUS and designates six other members – the Secretaries of Homeland Security, Commerce, Defense, State, Energy (a new member) and the Attorney General. The Secretary of Labor and the Director of National Intelligence are added as non-voting, ex officio members. The President can designate additional members, including the heads of White House agencies, generally or on a case-by-case basis. CFIUS may also consult with any other agency or "independent establishments," as deemed appropriate.

FINSA creates a new position, the Assistant Secretary of the Treasury, who will report to the Undersecretary for International Affairs and oversee the CFIUS process. FINSA authorizes the Treasury Department to appoint a "lead agency or agencies" for each transaction that will, among other things, be responsible for negotiating and enforcing mitigation agreements.

National Security. FINSA expands the list of factors to be considered by CFIUS in determining whether a proposed foreign investment transaction threatens U.S. national security. These new factors include the following:

- the effect on U.S. "critical infrastructure," including major energy assets;
- the effect on U.S. "critical technologies";¹
- whether the transaction is a "foreign government-controlled transaction";²
- adherence of the country in which the foreign person is located to nonproliferation control regimes, its cooperation in counterterrorism efforts, and the adequacy of its national export control laws and regulations, particularly with respect to the potential for transshipment or diversion of technologies with military applications;
- long-term U.S. requirements for energy and other critical resources and material, and
- any other factors the President or CFIUS determines to be appropriate.

These new factors will likely result in heightened scrutiny of foreign acquisitions of U.S. companies by persons and entities located in certain countries that have been the subject of critical review or commentary by the U.S. government in many of the areas noted above.

CFIUS Process. FINSA maintains the existing time frames for conducting the Exon-Florio national security reviews and investigations. Upon notification of a transaction, CFIUS conducts a 30-day review. During this review, the Director of National Intelligence will be required to conduct a thorough analysis of potential national security concerns. Following completion of the 30-day review, transactions will be subject to a subsequent 45-day investigation if any of the following apply:

- the proposed transaction threatens to impair U.S. national security and the threat has not been mitigated during the review;
- the proposed transaction is a foreign government-controlled transaction;
- the proposed transaction would result in foreign control of any critical infrastructure and could impair U.S. national security, unless the alleged impairment has been mitigated during the review, or
- the lead agency and CFIUS concur that an investigation should occur.

FINSA does provide an exception to the

requirement for an investigation of both a foreign government-controlled transaction or one involving critical infrastructure if the Secretary of the Treasury and the head of the lead agency considering the transaction jointly determine, on the basis of the CFIUS review, that the transaction will not impair the national security.

Mitigation Agreements. FINSA provides a statutory basis for what has been an informal CFIUS practice of negotiating mitigation agreements with parties to address national security concerns.⁴ However, FINSA further provides a new provision that authorizes CFIUS to reopen a case after its clearance if a party is found to have (a) submitted false or misleading material information to CFIUS, or (b) materially breached the mitigation agreement. CFIUS can only reopen a transaction for a material breach based on a finding by the lead agency of intentional breach and a finding by all CFIUS members that no other remedies are available. The remedies for a breach of a mitigation agreement include civil penalties and divestiture.

This new authority to re-open previously cleared transactions on grounds of breaches of mitigation agreements follows CFIUS practice under current (i.e., pre-FINSA) law of including so-called "evergreen" provisions in some recent mitigation agreements entered into with parties to several high-profile CFIUS proceedings.

Withdrawal of Notice. Where a notice is withdrawn prior to completion of a review or investigation, FINSA authorizes CFIUS to establish "interim protections" to address specific national security concerns raised in the proceeding pending resubmission of the notice. CFIUS is required to track any actions taken by a party between withdrawal and resubmission of a notice.

Congressional Oversight. Congress will receive a certified written notice and report at the conclusion of the CFIUS process for all reviews and investigations. These will be sent in each case to designated House and Senate leadership, House Members and Senators in key committees with jurisdiction over CFIUS and, for transactions involving critical infrastructure, to the Senators and Representatives of the state and congressional district, respectively, in which the target U.S. company's principal place of business is located. The reports must describe the actions taken by CFIUS, identify the determinative factors considered, and provide written assurance that the transaction either does not threaten to impair U.S. national security or that mitigation agreements have addressed any concerns.

FINSA also provides that any Member of Congress who received a CFIUS notice and report by virtue of holding a leadership position may request a briefing on the transaction or compliance with any mitigation agreement imposed.

Briefings may be classified and provided to staff having the necessary security clearance. Finally, FINSA requires detailed annual reports to Congress on the activities of CFIUS, including information on the transactions that have been reviewed or investigated within the previous 12 months.

Regulations and Guidance. Within 180 days after the effective date of FINSA (90 days after the date of enactment), CFIUS is required to publish implementing regulations. In addition, CFIUS is required to publish guidance on the types of transactions that have been reviewed and that have raised national security considerations, particularly

those involving foreign control of critical infrastructure.

Analysis

On one level, FINSA merely codifies many existing CFIUS practices that were informally adopted in response to recent high-profile transactions and congressional concerns regarding how the CFIUS process dealt with them. In many ways, the FINSA amendments to the Exon-Florio law should increase the transparency of the CFIUS process and ultimately lead to greater predictability.

Nevertheless, it is also clear that FINSA makes the CFIUS process more public than before and subject to increased policy and political review by greatly expanding congressional oversight, requiring the consideration of additional factors in assessing the national security implications of a proposed transaction, and expanding the number of agencies potentially involved in CFIUS reviews and investigations. Therefore, the FINSA amendments create new and additional opportunities and avenues for competitors of the parties and/or opponents of a proposed transaction to have an impact on the CFIUS process in order to block or heavily condition a transaction, or dissuade a potential buyer. These new dynamics, in turn, will require CFIUS to be far more proactive and searching in its reviews and investigations, thereby likely resulting in a more formal process covering a greater number of transactions, creating more opportunities for delay, and subjecting more transactions to mitigation agreements. Similarly, the "evergreen" provision for post-clearance reopening of transactions when and if mitigation agreements are breached results in less certainty regarding the finality of CFIUS determinations and places a premium on parties being accurate, complete and candid in submitting information to CFIUS.

In order to confront the new challenges posed by the FINSA amendments to the Exon-Florio national security process, parties to foreign investment transactions will need to be better prepared before submitting a notice of a proposed transaction to CFIUS. This will include building support for the transaction in advance of the filing by educating stakeholders in Congress, CFIUS, states and communities that the proposed transaction not only does not threaten U.S. national security, but also will not adversely impact a myriad of other concerns, such as jobs, competition, U.S. foreign relations and the environment. Companies contemplating foreign investment transactions should engage knowledgeable, experienced and sophisticated advisors to help develop appropriate strategies – addressing relevant regulatory, policy and political issues – for successfully completing the new, more demanding CFIUS process.

¹ The term "critical infrastructure" means systems and assets "so vital to the United States that the incapacity or destruction of such systems or assets would have a debilitating impact on national security."

² The term "critical technologies" includes technology or components "essential to national defense." These items will be identified in regulations implementing the FINSA amendments.

³ A "foreign government-controlled transaction" is one that could result in the control of a U.S. business by a foreign government or an entity controlled by or acting on behalf of a foreign government.

⁴ These agreements can cover, among other things, additional reporting requirements, new or enhanced compliance programs, and special ownership arrangements to negate foreign ownership, control and influence.