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Congress Passes Legislation to Strengthen Review of Foreign Investments in the United States

Summary

Under the 1988 Exon-Florio Amendment to the Defense Production Act of 1950, the President of the United States has authority to review the national security effects of foreign acquisitions of US companies. To date, that authority has been implemented, pursuant to Executive Order, through an interagency group of 12 federal agencies known as the Committee on Foreign Investment in the United States (CFIUS). On July 11, 2007, the United States Congress passed H.R. 556, the Foreign Investment and National Security Act of 2007, a law to reform the review of foreign investments by CFIUS.

The legislation is the culmination of the controversy that arose from the 2006 effort by the state-owned Dubai Ports World to acquire container terminals at US ports. The Administration – through CFIUS – had approved Dubai Ports World's acquisition of those assets. As news of the acquisition circulated, however, a significant controversy emerged in Congress. Congress quickly held a series of hearings and threatened to reverse the CFIUS approval through legislation. Under this threat, Dubai Ports World agreed to divest itself of the port assets, and thereafter did so.

In the aftermath of that transaction, the CFIUS process has come under intense scrutiny, and the internal executive branch process for approval of foreign acquisitions has become increasingly more rigorous. Congress has now legislated to make this more intense scrutiny permanent. The President is expected to sign the bill, which will become effective 90 days later. Among other things, this legislation will codify:

- The CFIUS process involving a 30-day "review," followed, if necessary, by a 45-day "investigation" of a foreign acquisition, with mandatory involvement of high level appointees in relevant executive agencies;
- A requirement for increased scrutiny of transactions that may affect US "critical infrastructure" (likely including port, rail, electrical generation, telecommunications and other assets) or other sensitive subject matter, so that clearance of such transactions must now involve thorough vetting of intelligence and vulnerability issues;
- A mechanism for clearing appropriate transactions with "mitigation agreements" to address national security concerns, and continuing governmental scrutiny to ensure compliance with those agreements;

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- An “evergreen” mechanism explicitly permitting the government to *reopen* cleared transactions if a company misrepresented any material facts in a prior filing, or materially breached a mitigation agreement; and
- A permanent mechanism for congressional notification and oversight which will continue to bring high level political attention to the CFIUS process and to cleared transactions.

Together, these changes will mandate a very high level of scrutiny of certain sensitive foreign acquisitions. Accordingly, it is critical to navigate the CFIUS process carefully with an eye to security *and* any political sensitivities. Once a transaction is approved, it is also prudent to develop a robust internal compliance system for any applicable mitigation agreement.

Background

In 1988, Congress enacted the Exon-Florio Amendment to the Defense Production Act of 1950, giving the President of the United States the authority to review the national security effects of foreign acquisitions of US companies.¹ The President, in turn, delegated much of his authority under the statute to CFIUS, an inter-agency committee that had been established by Executive Order in 1975 to monitor foreign investments in the United States.² Currently, CFIUS is chaired by the Secretary of the Treasury and is comprised of the Secretaries of 11 other Executive Branch departments and agencies, including the Departments of Homeland Security, Justice, Defense, State and Commerce. Since assuming the responsibility of implementing the Exon-Florio Amendment, CFIUS has cleared more than 1,700 foreign acquisitions that parties voluntarily have submitted to it for a confidential review.³ CFIUS has completed its review of most

transactions within an initial statutorily provided 30-day review period, but a small number of transactions continue to be subject to investigations that by statute may last up to 45 days, after which time the President has up to 15 additional days to determine whether to suspend or prohibit the deal.⁴

Recent controversial transactions before CFIUS – particularly the Dubai Ports World transaction, but also deals such as the unsuccessful 2005 effort by the state-owned China National Offshore Oil Company to acquire Unocal – have focused significant negative congressional and media attention on the CFIUS process. The resulting scrutiny and criticism have led CFIUS to tighten its own procedures, among other things requiring decisions to be made only at the highest levels of the member agencies, referring more cases than ever before to 45-day investigations and increasingly requiring transaction parties to enter into agreements to mitigate national security concerns.⁵ Fearful that their deals may one day be the subject of public scrutiny, transaction parties also have been notifying CFIUS of their deals in record numbers.⁶ The tightening of the CFIUS process undoubtedly also has led some foreign investors to question whether to invest in the United States at all. Indeed, other countries around the world are now considering reciprocating by introducing their own versions of CFIUS and implementing similar restrictions on foreign investment.⁷

In the wake of the Dubai transaction, both Houses of Congress have also attempted to pass legislation intended to strengthen the CFIUS review process. While those efforts failed in 2006, both Houses quickly reached a consensus in 2007. On July 11, 2007, Congress passed H.R. 556, which is now awaiting the President's signature.

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Key Provisions of the Legislation

The legislation codifies CFIUS and attempts to strengthen the review process in a number of respects. Among other things, the legislation increases CFIUS' membership, requires decisions to be made at the highest levels of the member agencies, allows CFIUS to reopen completed reviews in the event of breaches of mitigation agreements, and expands congressional oversight. Yet the legislation also leaves much of the current regime in place, including the basic structure of the CFIUS process – the voluntariness of the filing and the 30-45-15 day structure. And, because it enacts into law many of the same restrictions and procedures that CFIUS has implemented over the past year, the legislation may not, as a practical matter, make many changes to the way most transactions currently are handled.

The key provisions of the legislation include the following:

Membership of CFIUS

The legislation specifically designates as members of CFIUS the Secretary of the Treasury (who remains as Chair), Secretary of Homeland Security, Secretary of Commerce, Secretary of Defense, Secretary of State and Attorney General – all of whom are currently members of CFIUS. The legislation also adds the Secretary of Energy and, as “nonvoting, *ex officio*” members, the Secretary of Labor and the Director of National Intelligence. The President may name the heads of other agencies to CFIUS as well.⁸ The role of the Director of National Intelligence will be limited to providing an intelligence analysis of any threat to national security, for which he is to consider the views of other relevant intelligence agencies.⁹ From the members, the Secretary of the Treasury also must designate a “lead agency” for each transaction, who will take the lead

in the review, including in negotiating and monitoring compliance with any mitigation agreement.¹⁰ The lead agency for a large percentage of transactions is likely to be the Department of Homeland Security, Defense or Justice.

Filing and Withdrawing Notices

The legislation continues to provide for transaction parties to initiate reviews by submitting voluntary notices of their transactions to CFIUS.¹¹ In submitting a notice of a transaction or in providing any follow-up information, the chief executive officer of the submitting company, or his designee, will now be required to certify that the submission complies with all applicable requirements and is accurate and complete in all material respects.¹² The law also codifies the ability of parties, with approval from CFIUS, to request the withdrawal of a notice and thereafter to continue to discuss the transaction at issue with the agencies.¹³ In practice, the process of withdrawing and refileing a notice has become a useful way effectively to gain an extension of the initial 30-day review period without instituting a formal 45-day investigation.

Factors To Be Considered

The legislation adds several factors that CFIUS may consider in any review. The new factors include whether a transaction involves a country that the Secretary of Defense has identified as “posing a potential regional military threat” to US interests;¹⁴ the potential national security impact of the deal on US critical infrastructure, including major energy assets;¹⁵ the potential national security impact on critical technologies;¹⁶ and whether the transaction involves foreign government ownership.¹⁷ Particularly for a 45-day investigation, CFIUS also may consider the adherence of the particular country at issue to nonproliferation control regimes; the relationship of the country with the United States, specifically with

respect to its record of cooperating in counter-terrorism efforts; the potential for transshipment or diversion of technologies with military applications; and the long-term projection of US requirements for sources of energy and other critical resources and material.¹⁸

Transactions Involving Foreign Government-Controlled Acquirers and Critical Infrastructure

While the legislation specifies that 45-day investigations are required for, among other things, transactions involving foreign government-owned buyers and transactions that would result in foreign control of critical infrastructure,¹⁹ the legislation also carves out an exception to this requirement. Investigations will not be required for such transactions if the Secretary of the Treasury and the Secretary of the lead agency, who have limited delegation authority, jointly determine that the transaction will not impair US national security.²⁰

Mitigation and Enforcement

The legislation codifies the concept of a "mitigation agreement"²¹ – the range of agreements that various agencies have entered into with transaction parties to mitigate national security concerns. These agreements range from so-called "commitment letters" or "assurances letters" to network security agreements, special security agreements, proxy agreements and other arrangements or conditions that transaction parties may enter into with relevant government agencies. Under the legislation, mitigation agreements will continue to be based on risk-based analyses of the threat that a particular transaction poses to US national security.²² The lead agency will be responsible for negotiating the agreement with the parties and monitoring its implementation.²³ While it is unclear what the scope of the lead agency's monitoring role will be,

the legislation directs CFIUS to adopt methods to evaluate compliance with mitigation agreements "without placing unnecessary burdens on a party to a covered transaction."²⁴

Evergreen Provision

In addition to codifying the concept of mitigation agreements, the legislation allows those agreements to serve as a "hook" in perpetuity by which CFIUS can *reopen* completed reviews. While the legislation continues to allow CFIUS to reopen a previously completed review or investigation in the event a transaction party submitted false or misleading material information,²⁵ under the legislation an intentional material breach of a mitigation agreement can result in CFIUS's reopening a review or investigation, upon the lead agency's certification of the breach and a determination by CFIUS that no other remedies or enforcement tools are available to address the breach.²⁶ Thus, under certain circumstances, CFIUS could impose new, more burdensome conditions on a long-closed transaction, and even require divestitures. While CFIUS has begun to include such provisions in some recent mitigation agreements, it is too soon to tell what circumstances would trigger them.

Senior-Level Decisionmaking

The legislation requires that certain decisions be made only at the highest levels of the member agencies. For example, while the law allows the President or CFIUS to initiate reviews of transactions that parties may have elected not to submit for review, or to reopen completed reviews in the event that parties previously submitted materially misleading information or committed an intentional material breach of a mitigation agreement,²⁷ CFIUS's authority to do so may not be delegated to anyone other than the Deputy Secretary or an Under Secretary.²⁷ Likewise, the decision

whether to forego a 45-day investigation of transactions involving government ownership or critical infrastructure may not be delegated to anyone other than the Deputy Secretary of the Treasury or the deputy head of the lead agency.²⁹ The law places similar restrictions on the Secretary of the Treasury and the head of the lead agency in transmitting to Congress a certified notice (upon completion of each 30-day review) and a certified report (upon completion of each 45-day investigation where the transaction has not been sent to the President for decision).³⁰ The Secretary of the Treasury and the head of the lead agency may only delegate their authority to submit the certified notice or report to a presidential appointee who has been confirmed by the Senate (in the case of a notice of a review) or a Deputy Secretary (in the case of a report of an investigation).³¹

No Judicial Review

The law explicitly provides that neither the President's decision to suspend or prohibit a transaction, nor the findings on which he bases his decision, are subject to judicial review.³² This, of course, heightens the importance of carefully navigating the CFIUS process.

Congressional Reporting and Oversight

The law ensures continued congressional oversight by giving CFIUS additional reporting obligations to Congress. First, as noted above, the legislation requires that the CFIUS chairperson and the head of the lead agency transmit certified notices and reports to potentially over a dozen members of Congress following completion of any CFIUS review or investigation of a particular transaction.³³ These Senators and Congressmen also may request a briefing at any time on a completed review or mitigation agreement.³⁴ As a result, Congress will have the opportunity following

any review or investigation to conduct oversight. Indeed, depending on the political climate and the sensitivity of the transaction, the notified Senators and Congressmen may feel obligated to make inquiries. As a consequence, CFIUS will expect a high level of congressional scrutiny and may be very sensitive to transactions that could spur political controversy.

In addition, the legislation provides for an annual report to Congress on all reviews and investigations over the course of the year.³⁵ With respect to transactions relating to critical technologies, the annual report must include classified evaluations of whether there is "credible evidence of a coordinated strategy by 1 or more countries or companies to acquire United States companies involved in research, development, or production of critical technologies for which the United States is a leading producer" and "whether there are industrial espionage activities directed or directly assisted by foreign governments against private United States companies aimed at obtaining commercial secrets related to critical technologies."³⁶ An additional annual report by the Secretary of the Treasury, in consultation with the Secretaries of Treasury, State and Commerce, will be based on an annual study on foreign direct investments in the United States, particularly in critical infrastructure and industries affecting national security, by foreign governments, foreign government-controlled entities, or foreign persons which comply with any boycott of Israel or do not ban foreign terrorist organizations.³⁷

Implementing Regulations

The law directs the President to promulgate regulations, subject to notice and comment, that will take effect not later than 180 days after the effective date of the law.³⁸ Presumably, this task will fall to the Secretary of the Treasury, as Chair of CFIUS. In addition, by the

same deadline, the law directs the Secretary of the Treasury to publish guidance in the Federal Register on the types of transactions that CFIUS has reviewed and that have presented national security considerations, including transactions that could result in control of critical infrastructure by a foreign government or foreign government-controlled entity.³⁹

Potential Impact on Future Foreign Investments

The fallout from last year's Dubai Ports World controversy is not over yet. While the legislation, in and of itself, probably does not add materially to foreign investors' current regulatory burdens, it will ensure that CFIUS continues to accord heightened scrutiny to foreign investment for the foreseeable future. Moreover, the increased reporting to Congress will no doubt lead to some level of additional congressional oversight and involvement, particularly regarding sensitive transactions, and thus possible politicization of the process.

Nevertheless, many foreign investors (those who do not seek to acquire "critical infrastructure" and have no links to a foreign sovereign) may not feel significant additional impact from the enactment of the legislation, other than the need to follow a process that has become, and will remain, somewhat more cumbersome than it used to be. But whether the new law ultimately will help restore much needed certainty and predictability to the CFIUS process, and lessen the intense political scrutiny that recently has so burdened the process, is far from clear.

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CFIUS experts in the United States, having successfully represented dozens of clients in a wide range of industries before CFIUS and its various constituent agencies. In particular, she has handled numerous high-profile transactions involving foreign acquisitions of critical infrastructure, including in the telecommunications, technology, energy and defense industries.

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Endnotes

- ¹ Omnibus Trade and Competitiveness Act of 1988 § 5021, 50 U.S.C. app. § 2170 (1994).
- ² Exec. Order No. 11,858, 3 C.F.R. 990 (1971-1975), *reprinted as amended in* 15 U.S.C.A. § 78b note (2007).
- ³ *Committee On Foreign Investment in the United States (CFIUS), One Year After Dubai Ports World: Hearing Before the H. Comm. On Financial Services*, 105th Cong. (Feb. 7, 2007) (Testimony of Assistant Treasury Secretary Clay Lowery), *available at* http://www.house.gov/apps/list/hearing/financialsvcs_dem/htlowery020707.pdf. (Lowery Testimony).
- ⁴ 50 U.S.C. app. § 2170 (a), (c) (1994).
- ⁵ See Lowery Testimony (listing reforms that CFIUS has implemented following the Dubai Ports World transaction).
- ⁶ See US Department of the Treasury, *Fact Sheet: An Open Economy is Vital to United States Prosperity*, (May 10, 2007) *available at* <http://www.treas.gov/press/releases/hp395.htm>. (noting that approximately twice as many Exon-Florio notices were filed in 2006 than the average since 2000).

- ⁷ See Deborah Solomon, *Foreign Investors Face New Hurdles Across the Globe: China, Canada, Russia Grow Wary of Acquirers; Risk for Multinationals*, Wall Street Journal, July 6, 2007, at A1.
- ⁸ H.R. 556, 100th Cong. § 3 (adding new subsection (k)(2)).
- ⁹ *Id.* at § 2 (adding new subsection (b)(4)).
- ¹⁰ *Id.* at § 3 (adding new subsection (k)(5)).
- ¹¹ *Id.* at § 2 (adding new subsection (b)(1)(C)(i)).
- ¹² *Id.* at § 8 (adding new subsection (n)).
- ¹³ *Id.* at § 2 (adding new subsection (b)(1)(C)(ii), (iii)).
- ¹⁴ *Id.* at § 4 (adding new subsection (f)(2)(B)).
- ¹⁵ *Id.* (adding new subsection (f)(6)). The law 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.” *Id.* at § 2 (adding new subsection (a)(6)). This definition provides little guidance, however, and it is an open question how CFIUS will construe the term.
- ¹⁶ *Id.* at § 4 (adding new subsection (f)(7)).
- ¹⁷ *Id.* (adding new subsection (f)(8)).
- ¹⁸ *Id.* (adding new subsection (f)(9)).
- ¹⁹ *Id.* at § 2 (adding new subsections (b)(2)(A), (B)).
- ²⁰ *Id.* (adding new subsection (b)(2)(D)).
- ²¹ *Id.* at § 5 (adding new subsection (l)(1)(A)).
- ²² *Id.* (adding new subsection (l)(1)(B)).
- ²³ *Id.* (adding new subsection (l)(3)).
- ²⁴ *Id.* at § 5 (adding new subsection (l)(3)(B)(ii)(II)).
- ²⁵ *Id.* at § 2 (adding new subsection (b)(1)(D)(ii)).
- ²⁶ *Id.* (adding new subsection (b)(1)(D)(iii)).
- ²⁷ *Id.* (adding new subsection (b)(1)(D)).
- ²⁸ *Id.* (adding new subsection (b)(1)(F)).
- ²⁹ *Id.* (adding new subsection (b)(2)(D)(ii)).
- ³⁰ *Id.* (adding new subsections (b)(3)(A), (B)).
- ³¹ *Id.* (adding new subsection (b)(3)(C)(iv)).
- ³² *Id.* at § 6 (adding new subsection (e)).
- ³³ The certified notices and reports go to the majority and minority leader of the Senate; the Chair and ranking member of the Senate Committee on Banking, Housing and Urban Affairs and of any Senate Committee having oversight over the lead agency; the Speaker and minority leader of the House; the chair and ranking member of the House Committee on Financial Services and of any House committee having oversight over the lead agency; and, for transactions involving critical infrastructure, the members of the Senate from the State in which the principal place of business of the acquired US person is located, and the member from the congressional district in which the principal place of business is located. *Id.* at § 2 (adding new subsection (b)(3)(C)(iii)).
- ³⁴ *Id.* at § 7(a) (adding new subsection (g)(1)).
- ³⁵ *Id.* at § 7(b) (adding new subsection (m)).
- ³⁶ *Id.* (adding new subsection (m)(3)(A), (B)).
- ³⁷ *Id.* at § 7(c).
- ³⁸ *Id.* at § 9 (adding new subsection (h)); *see also* § 2 (adding subsection (b)(7)).
- ³⁹ *Id.* at § 2 (adding new subsection (b)(2)(E)).

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