

President Signs Legislation Reforming U.S. National Security Reviews of Foreign Investments in U.S. Companies

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If you have any questions regarding the matters discussed in this newsletter, please contact the following attorneys or call your regular Skadden contact.

Ivan A. Schlager
Washington, D.C. Office
202-371-7810
ischlage@skadden.com

Warren G. Lavey
Chicago Office
312-407-0830
wlavey@skadden.com

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I. EXECUTIVE SUMMARY

President Bush today signed the “Foreign Investment and National Security Act of 2007” (FINSA) into law, revising U.S. national security reviews of foreign investments in U.S.-based entities. In addition to codifying certain existing practices, FINSA will make reviews more rigorous, particularly for transactions in certain sensitive sectors, including critical infrastructure and critical technologies, as well as transactions involving an entity controlled by a foreign government. By strengthening the review process, FINSA should help remove the political uncertainty that has affected some high-profile, cross-border transactions in recent years.

FINSA results from the controversy surrounding both China National Offshore Oil Corporation’s (CNOOC) unsolicited bid for Unocal and Dubai Ports World’s (DPW) attempt to acquire port facilities in the United States. Both of these transactions generated intense political opposition and heightened interest in national security issues arising from foreign acquisitions of U.S.-based entities.

Most notably, FINSA statutorily modifies the operations of the interagency Committee on Foreign Investment in the United States (CFIUS), which reviews the national security implications of foreign acquisitions of, mergers with or investments in U.S.-based entities. Many of the changes in the legislation simply codify practices that already have become part of the CFIUS process. In particular, FINSA amends the CFIUS review process by:

- expanding the concept of “national security” so as to expressly include transactions involving critical infrastructure (including energy assets¹) and critical technologies as transactions subject to the CFIUS process;
- heightening CFIUS scrutiny for all transactions involving entities controlled by foreign governments;
- statutorily empowering CFIUS with the authority to negotiate, impose and enforce conditions necessary to mitigate any threat to national security arising from a transaction; and
- eliminating the safe harbor that protected transactions cleared by CFIUS from future scrutiny (and potential unwinding) if parties to the transaction intentionally and materially breach any term of a mitigation agreement and CFIUS determines that no other remedies are available to remedy such breach.

FINSA does not change the voluntary nature of the CFIUS filing process.² Foreign entities seeking to purchase or merge with U.S.-based entities, however, can be expected

¹ FINSA does not expressly define the scope of the term of “energy assets.” However, the context of its passage and its legislative history implies that Congress expects CFIUS to interpret this term broadly to include: electrical generating, transmission and distribution facilities; and gas storage, transmission, and distribution facilities (including LNG facilities).

² Historically, most foreign entities seeking to acquire U.S. companies did not file with CFIUS because their transactions did not pose a serious risk to national security.

to file with greater frequency than they have in the past because transactions involving critical infrastructure and critical technology assets are now statutorily considered to affect national security, subjecting them to CFIUS review. FINSA also increases the importance of managing the prefiling CFIUS period to ensure that the filing contains all of the information necessary for CFIUS to complete a timely review. Parties to a transaction subject to CFIUS review should factor this prefiling period into their contemplated closing schedule. Parties can expect the total time required to obtain CFIUS clearance for subjected transactions to be two to six months.

Finally, it is important to note that FINSA's expansion of the CFIUS review process to transactions involving critical infrastructure and critical technology assets does not necessarily mean that such transactions will be blocked. Since the CNOOC and DPW transactions, Skadden has successfully obtained CFIUS clearance for, among others, the following transactions:

- Dubai Aerospace Enterprise's purchase of Standard Aero and Piedmont/Hawthorne (providers of aircraft maintenance and repair services),
- Toshiba's purchase of Westinghouse (a nuclear reactor, fuel and component manufacturer) and
- Alcatel's merger with Lucent (a maker of high-technology communications equipment).

II. BACKGROUND

CFIUS is an interagency committee, chaired by the Secretary of the Treasury, that serves the president by reviewing the national security implications of foreign investment in the U.S. economy. It was first established by an executive order issued by President Ford in 1975.³ In 1988, amid concerns over foreign acquisitions of certain types of U.S. firms, Congress passed the Exon-Florio Amendment to the Defense Production Act of 1950, which effectively codified the basic CFIUS process established by President Ford's 1975 executive order.⁴ The Exon-Florio Amendment granted the president the express authority to review and block proposed or pending foreign acquisitions of U.S.-based entities that threaten national security. The review undertaken by CFIUS only applies to proposed or completed transactions that would give a foreign person "control" over a U.S. business.

Filing for CFIUS review of a transaction is voluntary, and a transaction may receive clearance after a 30-day initial review period or be subject to an additional 45-day national security investigation. The Exon-Florio Amendment, however, was itself amended in 1993 (the Byrd Amendment)⁵ to require a full, 45-day national security investigation for transactions involving: (i) an acquirer that is controlled by or acting on behalf of a foreign government and (ii) an acquisition that could affect U.S. national security. Until recently, CFIUS applied a fairly narrow interpretation of the Byrd Amendment. As a result, many filed transactions involving foreign government-controlled entities, including the DPW transaction, did not receive full, 45-day national security investigations. CFIUS also allowed many other transactions involving foreign government-controlled entities to close without requiring a filing and review, reflecting CFIUS' apparent view that those transactions were primarily commercial in nature and could not affect the national security of the United States.

As a result of the CNOOC and DPW transactions, Congress and the Bush Administration began an effort to update and strengthen the CFIUS review process, culminating in the enactment of FINSA. The new law builds upon the CFIUS process; it does not replace it.

³ Executive Order 11858 (b), 40 Fed. Reg. 20,263 (May 7, 1975)

⁴ Defense Production Act, Title VII, Section 721, 50 U.S.C. § 2158 *et seq.*

⁵ Section 837(a) of the National Defense Authorization Act for Fiscal Year 1993, called the Byrd Amendment, amended Section 721 of the Defense Production Act (a/k/a the Exon-Florio Amendment).

III. FINSA MODIFICATIONS TO THE CFIUS PROCESS

A. Structure

Membership in CFIUS was not historically determined by statute. The president appointed representatives from 12 agencies of the U.S. government.⁶ Under FINSA, however, membership in CFIUS must include the Secretary of the Treasury, the Secretary of State, the Secretary of Commerce, the Secretary of Defense, the Secretary of the Department of Homeland Security, the Attorney General, the Secretary of Energy (a new addition), the Secretary of Labor (a new nonvoting member), and the Director of National Intelligence (a new nonvoting member).⁷ The Secretary of the Treasury will continue to chair CFIUS. FINSA also grants the president the discretion to appoint additional representatives from other executive departments, agencies or offices. FINSA further mandates the designation of a lead agency for each transaction. The lead agency is charged with negotiating any mitigation agreement or other conditions to protect U.S. national security and to enforce the terms of any agreement. Finally, the legislation requires CFIUS to adopt a tracking system for monitoring voluntarily withdrawn applications and additional standards for reopening review of cleared and/or completed transactions.

B. Process

FINSA does not change the voluntary nature of the CFIUS filing process, and CFIUS may still initiate a review on its own.⁸ FINSA codifies existing practice by permitting CFIUS to negotiate, impose and enforce an agreement to mitigate any threat to U.S. national security imposed by a transaction. It also does not affect the confidentiality of documents or information provided to CFIUS and such materials remain protected from disclosure to Congress. FINSA continues the tradition of permitting parties to a transaction to meet on an informal basis with CFIUS staff during the prefiling period to ensure that the formal filing will contain all of the necessary information required for a complete review. These prefiling discussions allow CFIUS additional time to develop its analyses and request supplemental information from the parties.

1. 30-Day Review

FINSA maintains the existing timeframes for CFIUS' review of a transaction. After it receives the initial formal notification from the parties, CFIUS still has 30 days to decide whether to conduct a further 45-day investigation of a transaction if it determines that the transaction "threatens to impair the national security of the United States." If CFIUS unanimously concludes at the end of this 30-day review period that the transaction does not threaten to impair the national security, the review is terminated and the transaction is cleared.

2. 45-Day Investigation

Under FINSA, CFIUS must conduct a 45-day national security investigation in the following circumstances:

- the transaction threatens to impair U.S. national security, and the threat was not mitigated during the initial 30-day review;
- the acquirer is controlled by or acting on behalf of a foreign government;⁹
- the transaction could result in the control of any critical infrastructure or critical technologies, such as telecommunications facilities, energy assets and transportation infrastructure; or
- the lead agency and CFIUS determine, during the initial 30-day review, that the transaction threatens to impair national security.

⁶ Members under the previous regulations included: the Secretaries of Treasury, State, Defense, Homeland Security and Commerce; the Attorney General; the National Security Advisor; the U.S. Trade Representative; the Assistant to the President for Economic Policy; and representatives from the Office of Management and Budget, the President's Council of Economic Advisers, and the Office of Science and Technology.

⁷ In addition to designating the Director of National Intelligence as a member of CFIUS, FINSA also mandates that the Director of National Intelligence investigate threats to national security posed by foreign purchases of U.S. assets and advise the CFIUS agencies accordingly.

⁸ For example, based on press reports that a particular transaction has been agreed to or occurred.

⁹ An investigation is not required for transactions involving a foreign government-controlled entity if the Secretary or Deputy Secretary of the Treasury and the head of the lead agency jointly determine that the transaction will not impair the national security of the United States.

At the conclusion of the investigation or the 45-day period, CFIUS customarily prepares a report to the president and can recommend that the president suspend or prohibit the investment. The president must act within 15 days of receiving CFIUS' report.¹⁰

3. Safe Harbor

Prior to FINSA, transactions receiving CFIUS clearance operated under a statutory safe harbor that protected them from post-closing scrutiny by CFIUS, which could have included asset divestitures or potential unwinding. FINSA modifies prior regulation by eliminating the safe harbor for cleared transactions if the parties intentionally and materially breach a term of any mitigation agreement and CFIUS determines that no other remedies or enforcement tools are available to address such breach. FINSA also reinforces CFIUS' existing capacity to refuse, suspend, modify or reverse any transaction if a written notice of such transaction is not filed with CFIUS or if there is an intentional material omission or falsehood in connection with a completed CFIUS review or investigation.

C. Factors To Be Considered

The Exon-Florio Amendment (as amended by the Byrd Amendment) lists five factors to be considered by CFIUS in determining the effects of a proposed transaction by a foreign entity on national security. Two of the factors emphasize the national defense aspects of foreign acquisitions,¹¹ while the other three factors highlight national security implications of such investment.¹² FINSA adds several additional factors that CFIUS must consider. These factors include the potential impact of a transaction on: (i) critical infrastructure (including energy assets) or critical technologies; (ii) long-term projections of U.S. requirements for various energy sources and other critical resources; and (iii) particularly with respect to transactions involving foreign government-controlled entities, whether such foreign governments are in compliance with U.S. and multilateral counterterrorism, proliferation and export control regimes.

D. Oversight

Finally, FINSA strengthens the CFIUS review process and Congressional oversight of that process by requiring CFIUS to provide written notice to Congress at the conclusion of both 30-day reviews and 45-day investigations and detailed annual reports on its activities.

IV. CONTINUED OPENNESS FOR FOREIGN INVESTMENT

Both the executive branch and Congress have characterized FINSA as a careful approach to protecting national security while ensuring continued openness to foreign direct investment in the United States and foreign markets to U.S. direct investment. CFIUS has been, and will likely continue to be, sensitive to the potential chilling effect on foreign investment of 45-day investigations, extensive mitigation agreements, or the unwinding, blocking or withdrawal of transactions. In implementing the additional FINSA measures, CFIUS also will attempt to avoid deterring foreign companies from investing in and acquiring U.S. businesses. Finally, while national security reviews by foreign governments are increasing, CFIUS will seek to avoid triggering foreign governments to erect barriers to U.S. investment.

¹⁰ Historically, the president has followed CFIUS' recommendations, and each recommendation to the president has had the unanimous support of the CFIUS member agencies.

¹¹ Under these two factors CFIUS must consider the effect on: (i) "the domestic production needed for projected national defense requirements" and (ii) "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." See 50 U.S.C. App. 2170(f)(1) and (2).

¹² Under these three factors CFIUS must consider the effect on: (i) "the control of domestic industries and commercial activity by foreign citizens as it affects the capability and capacity of the [U.S.] to meet the requirements of national security;" (ii) the potential effects of the proposed or pending transaction on sales of military goods, equipment or technology to any country (A) determined by the Secretary of State under the Export Administration Act of 1979 [either] ... as a country that supports terrorism ... as a country of concern regarding missile proliferation; or ... as a country of concern regarding the proliferation of chemical and biological weapons; or (B) listed under Section 309(c) of the Nuclear Non-Proliferation Act of 1978 on the 'Nuclear Non-Proliferation-Special Country List' ... or any successor list;" and (iii) "the potential effects of the proposed or pending transaction on [U.S.] international technological leadership in areas affecting [U.S.] national security." See 50 U.S.C. App. 2170(f)(3), (4) and (5).