National Security based Investment Review
In the United States

1. Introduction

General review of proposed foreign investments in existing U.S. industries began when Congress enacted the so-called Exon-Florio Amendment, Section 721 of the Defense Production Act of 1950, as part of the Omnibus Trade and Competitiveness Act of 1988.\(^1\) Under that amendment the President was given authority to block or suspend a merger, acquisition or takeover by a foreign entity if there is “credible evidence” that a “foreign interest exercising control might take action that threatens to impair the national security” and existing provisions of law do not provide “adequate and appropriate authority for the President to protect the national security in the matter before the President.”\(^2\) The amendment followed a period of increased foreign direct investment in U.S. businesses. General concerns about the impact of these acquisitions on U.S. national security escalated in 1987 when Fujitsu, a Japanese electronics company, proposed to acquire Fairchild Semiconductor Corporation.\(^3\) Fairchild was widely seen as the “mother company” of Silicon Valley, and many viewed the semiconductor industry as being critical to the development of high-technology weaponry.\(^4\) In addition, some observers argued that permitting Fujitsu to acquire Fairchild would further encourage anticompetitive practices by Japanese businesses and foster U.S. dependence on Japanese suppliers in the dual-use technology market.\(^5\)

The debate over an appropriate response to the proposed Fujitsu/Fairchild transaction reflected a number of concerns that continue to characterize discussions in the national security/foreign investment area: (1) What criteria should apply to determine a threat to “national security”? While there is little dispute that taking over a major defense supplier would have a national security impact, what about a takeover which threatens the economic security of a geographic area? (2) To what extent should the involvement of a foreign instrumentality such as a foreign government or a foreign-government entity affect the determination about the effect on national security? (3) To what extent should other foreign policy considerations affect the determination, such as the U.S. tradition of open investment and free markets and the possible impact of the U.S. action on foreign treatment of U.S. investors abroad? (4) To what extent is the claimed impact on national security simply a competitor seeking protection from competition? (5) To what extent does the President already have the authority to stop the proposed transaction on other grounds? For example, at the time Exon-Florio was enacted there was a dispute of whether the President didn’t already have the authority to investigate, regulate

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2 Id.
4 Id.
5 Id.
and prevent foreign acquisitions of U.S. companies under the International Emergency Economic Powers Act ("IEEPA")\(^6\)?

The resulting Exon-Florio amendment was a much more limited proposal that would authorize presidential action when the President makes a finding that there is "credible evidence that...the foreign interest exercising control might take action that threatens to impair the national security."\(^7\) The amendment was characterized by three essential aspects: 1) it was designed to provide residual authority to limit foreign direct investment if no other authority (apart from the IEEPA) is available to protect the national security;\(^8\) 2) action taken under the amendment must be grounded in facts developed through thorough, credible evaluation of a transaction; and 3) the amendment is to be interpreted and applied consistently with the United States’ long tradition of open international investment. The threat-to-"essential commerce” standard was rejected as a basis for blocking a proposed transaction.\(^9\)

Under the leadership of the Department of the Treasury, regulations were adopted which contemplated the following process: (1) an initial submission by the proposed acquirer containing relevant information regarding the acquirer, the target, and the proposed transaction, which begins a 30-day review by an inter-agency panel called the Committee on Foreign Investment in the United States and now known by the abbreviation “CFIUS” to determine whether the transaction merits a full investigation; (2) if CFIUS member agencies identify a national security concern, or if CFIUS is unable to complete its review within 30 days, CFIUS may either allow the companies to withdraw the notification or initiate a 45-day investigation; (3) if CFIUS concludes a 45-day investigation, it is required to submit a report to the President; and (4) the President then has 15 days to decide whether to approve the transaction and is required by Exon-Florio to submit a report to Congress setting forth his decision.

2. **Initial Experience under Exon-Florio**

The country’s experience under Exon-Florio over the next seventeen years largely indicated that many of the initial concerns had not been adequately addressed.

(a) **What constitutes a threat to “national security”?**

According to a comprehensive analysis prepared in mid-2005 by the Government Accountability Office (the “GAO Report”), the Treasury Department, in its role as the chair of CFIUS, largely defined potential threats to national security as acquisitions that involve export-controlled technologies/items and classified contracts, or where there was specific derogatory intelligence on the foreign company, particularly related to proliferation concerns. There was a developing consensus that this focus was too narrow.

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\(^7\) Exon-Florio, supra note 1, 50 U.S.C. app. § 2170(e)(2).

\(^8\) This is a much broader exception that one might think. Appendix A sets forth other statutes which might be used to protect against investments which might compromise U.S. security.

\(^9\) Alvarez, supra note 3, at 76.
The Exon-Florio amendments did not directly define national security but instead provided factors to be considered in identifying a threat to national security. These included:

- Domestic production needed for projected national defense requirements.
- 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.
- 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.
- The potential effect of the transaction on sales of military goods, equipment, or technology to any country identified under applicable law as (a) supporting terrorism or (b) a country of concern for missile proliferation or the proliferation of chemical and biological weapons.
- The potential effect of the transaction on U.S. international technological leadership in areas affecting national security.\(^{10}\)

Following the September 11 attacks there was an increased emphasis on protecting the United States from attack, and the Department of Homeland Security was added to CFIUS. However, some critics suggested that homeland security issues be addressed by proscribing foreign ownership of certain identified critical infrastructure assets, or by proscribing ownership by certain types of purchasers (as, for example, purchasers identified with a foreign government).

Another important question was the extent economic security should be considered in evaluating a threat to national security. In 2005, the 71% government-owned China National Offshore Oil Company (CNOOC) commenced negotiations to buy Unocal, the US’s eighth-biggest oil company, for $18.5 billion. A number of congressmen pressed the Bush administration to block the deal citing threats to U.S. energy security, concerns over lack of reciprocity by the Chinese government should a U.S. company try to buy a Chinese oil company, and unfairness in the bidding process because CNOOC would have access to cheap capital guaranteed by the Chinese government not available to other bidders. The debate surrounding the CNOOC/Unocal acquisition led Congress to respond by adopting measures asking the President to initiate a thorough review of the transaction from the perspective of energy and/or economic security\(^{11}\). More than one representative argued that access to energy resources is critical in order to protect the economy and the national security and that therefore energy security should be viewed as a fundamental aspect of national security.\(^{12}\) Separate bills introduced to amend Exon-Florio the following year also construed “national economic security” as being part of "national security." Furthermore, some U.S. trading partners had incorporated “economic security” into their laws governing national security review of foreign investment.

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Nevertheless, proposals focused on economic security continued to be rejected as inconsistent with a policy of open investment and maintaining US’s position as a free trade leader.¹³

(b) Involvement of a foreign government instrumentality. In early 2006, Dubai Ports World (DPW), a ports operator owned by the government of Dubai, proposed to pay $6.8 billion to acquire P&O, a British firm which operated a global network of maritime terminals, including six major U.S. ports. This transaction apparently did not come to the attention of Congress until after it had been approved by CFIUS, prompting a wave of protests by a cross-section of U.S. politicians including both Democratic and Republican governors and members of Congress. Politicians who opposed the deal expressed concern that U.S. ports are considered one of the weakest points of border security and this transaction would permit the purchase of key U.S. assets by a firm that was effectively an arm of a foreign government. Many of the critics also complained about the CFIUS review process, which in this case had been completed and the transaction approved within the 30-day review period without triggering more detailed scrutiny and without notifying Congress. Even though homeland security experts pointed out that security of the ports would continue to be managed by U.S. entities, including what is now known as U.S. Customs and Border Protection, and that DPW already managed operations involving Navy vessels overseas, the transaction remained unpopular. Ultimately, DPW agreed to divest its American port operations in response to the hostile reaction of members of Congress and the general public.

(c) Tradition of open investment and free markets. From its very inception, Exon-Florio had been characterized not as legislation to block foreign investment but rather to provide authority needed in extraordinary circumstances to protect the national security. For example, the 1988 Trade Act Conference Report specified that the Congress expected Exon-Florio to be implemented in a manner that is consistent with U.S. international obligations, which include many open-investment commitments.¹⁴ Congress believed that in the final version of Exon-Florio it had ensured that Exon-Florio would not be used as a protectionist tool to block international competition.

Congress’ commitment to maintaining an open investment policy has been repeatedly confirmed over the life of Exon-Florio. Indeed, many Members of Congress feared that the original legislation might be invoked to hinder foreign investment for illegitimate reasons.¹⁵ They also criticized the original proposal for being too broad and argued that it unnecessarily extended to friendly mergers, “synergistic” joint ventures, and other types of foreign investments that contribute to U.S. competitiveness.¹⁶ Furthermore, there was a concern that lack of a


¹⁵ June 10, 1987 Hearings, supra note 7, at 65-76.

¹⁶ Id. at 6, 21-22, 51, 53.
credible examination of a proposed transaction would increase investor uncertainty, which would further discourage foreign investment. 17

More recently, in 2006, Senator Richard Shelby (R-AL) continued this tradition when he began a hearing on Exon-Florio by reaffirming his strong support for an open investment policy. 18 The clear and consistent theme throughout the years of discussion about Exon-Florio is that the United States will be open to foreign investment except to the extent that it threatens the national security. Any adjustment to the FDI review regime had to meet this standard.

(d) Timeline

In addition to these substantive concerns, complaints had been frequently expressed with regard to the statutory time periods contemplated in Exon-Florio and the practice of some applicants of withdrawing and refiling an application, sometimes much later.

The statutory time periods. Critics often asserted that the 30-day and subsequent 45-day timelines were too short and that allowing withdrawal of a notification frustrated the review process. For example, the 2006 GAO Report noted that Defense Department analysts typically had only 3-10 days to analyze a foreign acquisition and report back to CFIUS. The GAO Report also noted that Treasury is reluctant to go to a full 45-day investigation, in part, because it happens so rarely that it has been interpreted to signal serious problems with the transaction and negatively impact financial aspects of the deal.

Withdrawing and Refiling. The GAO Report also identified numerous instances of companies withdrawing and refiling their CFIUS notification at a later date if the initial review and report by member agencies to CFIUS could not be completed in the statutory 30-day period. Companies withdrawing their notification usually refiled within a short period of time after resolving any outstanding issues. But in some cases the acquisition had already been completed and the companies—not surprisingly—were much less inclined to refile. In other instances, companies which had concluded an acquisition before filing with CFIUS withdrew and never refiled. As a result, there were fewer instances in which a report was submitted to Congress. The GAO Report blamed this practice for the opaque nature of the Exon-Florio process and suggested modifications, including revisiting the circumstances under which cases are reported to Congress, establishing interim protections in cases where specific concerns have been raised, setting specific time frames for refiling, and establishing a process for tracking actions being taken during the withdrawal period.

(e) Clarifying the appropriate role of Congress and the Department of Homeland Security.

As noted above, a number of politicians, including many members of Congress, reacted angrily when they learned of the approval of DPW’s proposed acquisition of P&O’s US port operations. This hostile reaction was assertedly triggered in part by the failure to inform

17 Id. at 11 (statement of Secretary Baldridge).
Congress of the pending transaction while it was being reviewed and subsequently approved by CFIUS. (Exon-Florio provided for Congressional notification only when the 30-day review warranted additional 45-day investigation and when the President made a decision following the investigation. By approving the DPW transaction within the initial 30-day review period, CFIUS did not trigger that notification requirement.) Of course, this also reflects the potential for the Exon-Florio process to become increasingly politicized as elected officials respond to the special interests of their constituents and attempt to delay or thwart a proposed acquisition.

Furthermore, some practitioners had suggested that CFIUS was using the investment review process to achieve national security goals in a manner which might arguably require a more direct Congressional authorization. For example, there was some indication that CFIUS had demanded that some non-U.S. telecommunications firms accept certain restrictions on their operating flexibility in order to permit U.S. security agencies to conduct electronic surveillance and access data for counterterrorism and law enforcement purposes under the Patriot Act. In return for these concessions, CFIUS had reportedly foregone a full investigation of the proposed transaction.

Finally, there was support for an increased role for some of the other agencies represented on CFIUS, particularly the Department of Homeland Security. Some of the proposed legislation included measures to elevate the Secretary of Homeland Security to serve as a co-chair of CFIUS along with Secretary of Treasury in order to increase emphasis on security issues. Theoretically, that would insure that major proposed transactions which affect critical US infrastructure in a way that threatens national security should be reviewed extensively by DHS before being cleared by CFIUS.

The Congress’ intent that a searching, objective inquiry be a precondition to action under Exon-Florio can also be inferred from the Congress’ reluctance to establish “bright-line” standards in the legislation. For example, the Congress intentionally left the term “national security” undefined. This indicates that the legislators did not want to make over- or under-inclusive, categorical advance judgments about the types of transactions that would give rise to the need for action. Rather, they wished the President to exercise discretion based on an accurate understanding of the relevant facts.

The Senate Commerce Committee proposed to limit the “essential commerce” criterion to essential commerce that “affects national security.” This improvement was deemed inadequate. After much debate, the legislation was adopted without any reference to “essential commerce.”

3. **Key Changes in Exon-Florio as a Result of the Foreign Investment and National Security Act of 2007 and Subsequent Regulations**

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In July 2007, Congress enacted the Foreign Investment and National Security Act ("FINSA")\(^22\). While a comprehensive review of the changes made by that statute is beyond the scope of this paper, it did address most of the prior criticisms of the foreign investment review process under Exon-Florio and sought thereby to create a more predictable and more comprehensive review process but at the same time a process which can be sufficiently flexible to tailor the Congress’ concerns over protection of national security with its concerns over continued protection of free investment. With respect to the issues identified earlier, FINSA enacted the following remedial measures:

(a) **Definition of National Security.** Congress continued to avoid developing a “bright-line” definition of what constitutes “national security”. Instead, it augmented the previous list of factors to be considered in reviewing covered transaction. In particular, it added:

- The effect of the proposed transaction on critical infrastructure;
- The effect of the proposed transaction on critical technologies;
- Whether the proposed transaction is a foreign government-controlled transactions;
- An assessment, as appropriate, of the source country’s adherence to nonproliferation controle regimes, its record on counterterrorism efforts, and the potential for diversion of technologies;
- The long-term requirements of the United States for energy and other critical resources.\(^23\)

(b) **Involvement of a Foreign Instrumentality.** As noted immediately above, whether a proposed transaction is a “foreign government-controlled transaction” was adopted as a specific factor to consider in evaluating the transaction’s impact on national security. In particular, FINSA defined the term “foreign government-controlled transaction,”\(^24\) made a national security investigation of the transaction mandatory (e.g., the 45-day investigation),\(^25\) which in turn made the action the subject of a certified written report to Congress setting out the results of the report on completion of the investigation.\(^26\)

(c) **Maintaining Open Investment and Free Markets** The use of mitigation agreements was narrowed to instances where CFIUS has conducted a risk-based analysis of the threat the covered transaction presents to national security and certifies that the transaction as mitigated does not present any unresolved national security concerns.\(^27\)

(d) **Timeline** The timeline was left unchanged, but Congress took a number of steps to make the process both more open and more predictable. Most

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\(^{24}\) Id §2170(a)(4).

\(^{25}\) Id §2170(b)(1)(B).

\(^{26}\) Id. §2170(b)(3)(B).

\(^{27}\) Id. §§2170(b)(3)(C)(ii); (l)(1)(B).
(e) Clarifying the Congressional Role. Congress took a number of steps to assure a greater oversight role. Most significantly, it required both at the completion of a national security review which concludes the review process and a national security investigation which concludes the review process, designated officials in the Department of the Treasury and the so-called “lead agency” (which is determined for each reviewed transaction on an individual basis) must certify that the transaction presents no unresolved national security concerns. This report must be sent to designated Congressional leaders and, in transactions involving critical infrastructure, to senators from the state and the representative from the district where the principal place of business of the proposed acquiree is located.28

It also required that an annual report on all reviews and investigations of covered transactions completed during the 12-month period covered by the report. The report is required to cover, among other things, information as to whether withdrawn notices were refiled or the transaction abandoned, the types of arrangements and conditions used in mitigation agreements, and a discussion of perceived adverse effects which will be considered by the committee in the next succeeding 12-month period.29

Finally, it inserted a requirement that CFIUS brief Congress as to any covered transaction for which the review process has been concluded upon the request of any member of Congress entitled to receive a copy of the certification described above. This briefing requirement also applies to transactions for which national security concerns have been addressed through a adoption of a mitigation agreement. Of course, this means that where critical infrastructure issues are involved in the covered transaction, the affected senators or representative may also invoke the briefing requirement.30

(f) Other Changes. Congress also made some other changes, not directly responsive to the issues listed above, which bear mention, including:

1. It expanded the membership of CFIUS to include the Secretary of Energy and made the Secretary of Labor and the Director of National Intelligence nonvoting ex officio members.31

2. It required filers to certify that their filings are complete and accurate and in compliance with the requirements of 50 U.S.C. App. §2170.32 applicable law.

3. It inserted a provision for negotiating, monitoring and enforcing compliance with mitigation agreements.33

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28 Id. §§2170(b)(3)(B), (C)(ii), and (C)(iii).
29 Id §2170(m).
30 Id. §2170(g)(1).
31 Id. §2170(k)(2).
32 Id. §2170(n).
33 Id. §2170(l)(3).
Since the enactment of FINSA, CFIUS has promulgated regulations clarifying, among other things, what constitutes a “covered transaction”, what is to be included in the notice of a covered transaction and the penalties for material omissions and misstatements, and clarifying the definition of various terms used in the FINSA statute. On September 3, 2009, CFIUS furnished Congress with its mandatory report on covered transactions during 2008 in classified form. An unclassified version of the report is now available.
Appendix A

Other Statutes which might be used to Protect National Security

There are a number of other means of protecting national security in connection with foreign direct investment, including:

(i) U.S. Export Control Laws, which target different national security or foreign policy objectives but which together constitute an important source of protection against loss or abuse of sensitive U.S.-origin technology. Some of these laws and regulations focus on protecting certain types of technology deemed to have significant national security implications; while others focus on identifying certain governments, entities, and individuals deemed to present national security issues. See, e.g., Foreign Assets Control Regulations (FACR), 31 C.F.R. § 500 et seq.; Export Administration Regulations (EAR), 15 C.F.R. § 730 et seq; International Traffic in Arms Regulations (ITAR), 22 C.F.R. § 120 et seq.34

(ii) The Anti-Assignment Act, 41 U.S.C. § 15, which provides as to contracts with the United States:

No contract or order, or any interest therein, shall be transferred by the party to whom such contract or order is given to any other party, and any such transfer shall cause the annulment of the contract or order transferred, so far as the United States is concerned.

Even if the assignment is “by operation of law” (i.e., in a statutory merger), affirmative government consent will be required unless it can be shown that the transaction will have little or no impact on any of the people, equipment, facilities or other resources originally engaged by the government at the time of the contract award.35

(iii) The National Industrial Security Program, which was created by Executive Order 12829 (January 6, 1993) to “safeguard Federal Government classified information that is released to contractors, licensees, and grantees of the United States Government”.

34 For example, the ITAR includes a detailed prior notification procedure under 22 C.F.R. § 122.4(b). A registrant must notify the Office of Defense Trade Controls at least 60 days in advance of any intended sale or transfer to a foreign person and furnish information to determine whether the authority of section 38(g)(6) of the Arms Export Control Act regarding licenses or other approvals for certain sales or transfers of articles or data should be invoked. Upon completion of such a notified transaction (assuming that DDTC has not objected to the transaction), there is a parallel second notification by the parties to the transaction to provide DDTC with additional prescribed information. See 22 C.F.R. § 122.4(c).

35 See, e.g., Johnson Controls World Services, Inc. v. United States, 44 Fed. Cl. 334, 343 (1999). See also Keydata Corp. v. United States, 504 F.2d 1115 (Ct. Cl. 1974). One of the changed circumstances that a federal contract officer will examine in applying the Anti-Assignment Act in the context of a foreign merger or acquisition of a defense contractor is whether the transaction will materially alter the national security interests of the United States in such a contract. If so, the government has the power to withhold its consent to the transfer of the federal contract to the foreign buyer, thereby triggering the Act and thus voiding both the attempted assignment as well as the underlying federal contract. 41 U.S.C. § 15(a).
(iv) **Industry-Specific Safeguards**, such as the Federal Aviation Act of 1958, 49 U.S.C. §§ 40101-49101; the Mineral Lands Leasing Act of 1920, 30 U.S.C. §§ 181-287; the Atomic Energy Act of 1954, 68 Stat. 921 (codified as amended in various sections of 42 U.S.C.) (limits foreign investment in nuclear energy production within the United States and bars issuance of licenses for production facilities to corporations that the Nuclear Regulatory Commission believes to be “owned, controlled, or dominated by an alien, a foreign corporation, or a foreign government”, 42 U.S.C. §2133); the Communications Act of 1934, 47 U.S.C. §§ 151-615 (restrictions on foreign ownership and investment in the wireless and radio communication field)

As these other laws suggest, if Congress believes there are specific infrastructure or other industrial assets in the United States that require protection for reasons of national security, there is ample precedent for industry-by-industry protections. In appropriate circumstances, Congress can place caps on the degree of foreign participation or even bar foreign ownership or control entirely on an industry-specific basis.