The Exon-Florio National Security Test for Foreign Investment

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Summary

The Exon-Florio provision grants the President the authority to block proposed or pending foreign acquisitions of "persons engaged in interstate commerce in the United States" that threaten to impair the national security. This provision came under intense scrutiny with the proposed acquisitions in 2006 of major operations in six major U.S. ports by Dubai Ports World and of Unocal by the China National Offshore Oil Corporation (CNOOC). The debate that followed reignited long-standing differences among Members of Congress and between Congress and the Administration over the role foreign acquisitions play in U.S. national security. The public debate underscored the differences between U.S. policy, which is to actively promote internationally the national treatment of foreign firms, and the concerns of some over the way this policy applies to companies that are owned by foreign governments that have unlimited access to the nation's industrial base. Much of this debate focused on the activities of a relatively obscure committee, the Committee on Foreign Investment in the United States (CFIUS) and the Exon-Florio provision, which gives the President broad powers to block certain types of foreign investment.

In the first session of the 110th Congress, Representative Maloney introduced H.R. 556, the National Security Foreign Investment Reform and Strengthened Transparency Act of 2007, on January 18, 2007. The measure was approved by the House Financial Services Committee on February 13, 2007, with amendments, and was approved with amendments by the full House on February 28, 2007, by a vote of 423 to 0. On June 13, 2007, Senator Dodd introduced S. 1610, the Foreign Investment and National Security Act (FINSA) of 2007. On June 29, 2007, the Senate adopted S. 1610 in lieu of H.R. 556 by unanimous consent. On July 11, 2007, the House accepted the Senate's version of H.R. 556 by a vote of 370-45 and sent the measure to the President, who signed it on July 26, 2007. It is designated as P.L. 110-49.

On January 23, 2008, President Bush issued Executive Order 13456 implementing the law. The Executive Order also establishes some caveats that may affect the way in which the law is implemented. These caveats stipulate that the President will provide information that is required under the law as long as it is "consistent" with the President's (1) authority to conduct the foreign affairs of the United States; (2) authority to withhold information that would impair the foreign relations, the national security, the deliberative processes of the executive, or the performance of the executive's constitutional duties; or (3) ability to supervise the unitary executive branch. Despite the recent changes to the Exon-Florio process, some Members continue to question the way in which the changes in the law are being interpreted by the Obama Administration and the way in which the law is being used to address cases involving foreign governments, particularly with the emergence of direct investments through sovereign wealth funds (SWFs). In the 112th Congress, some Members expressed their concerns to the Obama Administration over the national security implications of a proposed acquisition of a U.S. technology company by the Chinese-owned Huawei Technologies. The Obama Administration issued a statement on June 30, 2011, supporting an open investment policy, a commitment to treat all investors in a fair and equitable manner, and support for business investment from sources both home and abroad in the economy. On September 28, 2012, President Obama used the authority granted to him under FINSA to block a Chinese acquisition of a U.S. energy firm.

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Background

According to the Department of Commerce,[1] foreigners invested $234 billion in U.S. businesses and real estate in 2011, up from the $206 billion invested in 2010, as indicated in **Figure 1**. This amount reflects the rebound in direct investment activity as a result of the world-wide slump in foreign investment that occurred following the financial crisis of 2008-2009, a shortage of funds for acquisitions and mergers, and the global economic recession. Fluctuations in foreign direct investment flows, although particularly sharp for the United States, are not unique. According to the United Nations' *World Investment Report*, global foreign direct investment inflows increased by 16.5% in 2011, compared with 2010, and by 9.5% in 2010, after falling by 16% in 2008 and 37% in 2009, marking the bottom of the global slump in direct investment spending.[2]

The cumulative amount, or stock, of foreign direct investment in the United States on a historical cost basis[3] rose from $2.3 trillion in 2010 to about $2.5 trillion in 2011, after rising very slowly between 2008 and 2009.[4] The United States is both the largest recipient of foreign direct investment and the largest overseas direct investor. The rise in the value of foreign direct investment includes an upward valuation adjustment of existing investments and increased investment spending that was driven by the stronger growth rate of the U.S. economy, the world-wide resurgence in cross-border merger and acquisition activity, and investment in the U.S. financial and insurance industries.

[1] Scott, Sarah P., U.S. International Transactions: First Quarter of 2012. *Survey of Current Business*, July 2012, p. 59.

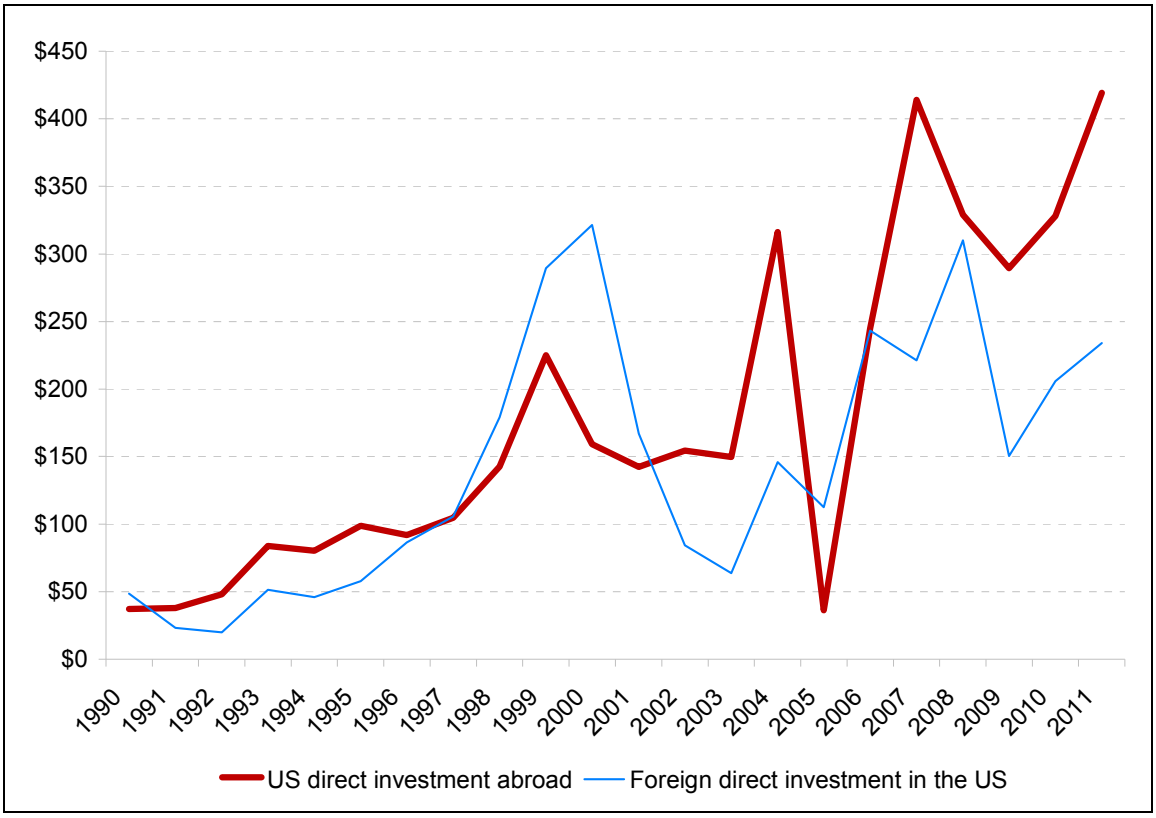
[2] *World Investment Report 2011: Non-Equity Modes of International Production and Development.* New York, United Nations, 2011, p. 1.

[3] The stock, or position, is the net book value of foreign direct investors' equity in, and outstanding loans to, their affiliates in the United States. A change in the position in a given year consists of three components: equity and intercompany inflows, reinvested earnings of incorporated affiliates, and valuation adjustments to account for changes in the value of financial assets. The Commerce Department also publishes data on the foreign direct investment position valued on a current-cost and market value bases. These estimates indicate that foreign direct investment increased by $311 billion measured at current cost, and by $112 billion measured at market value in 2011. The cumulative position valued at current cost in 2011 was $2.9 trillion, compared with a market value of $3.5 trillion.

[4] Barefoot, Kevin B. and Marilyn Ibarra-Caton, "Direct Investment Positions for 2011: Country and Industry Detail," *Survey of Current Business*, July 2012. p. 19.

Figure 1. Foreign Direct Investment in the United States and U.S. Direct Investment Abroad, Annual Flows, 1990-2011

(in billions of dollars)



Source: CRS from U.S. Department of Commerce data.

Note: the drop in U.S. direct investment abroad in 2005 reflects actions by U.S. parent companies to take advantage of a one-time tax provision.

With more than $442 billion invested in the United States, the United Kingdom is the largest foreign direct investor. Japan has moved into the position as the second-largest foreign direct investor in the U.S. economy with about $260 billion in investments. Following the Japanese are the Dutch ($240.3 billion), the Germans ($215.9 billion), the Canadians ($211 billion), and the French ($198.7 billion).

In the first session of the 110th Congress, Members approved, and President Bush signed, P.L. 110-49, which alters the national security process authorized under the Exon-Florio provision. The changes in the public law provide for greater oversight by Congress and increased reporting by the Committee on Foreign Investment in the United States (CFIUS) on its decisions. In addition, P.L. 110-49 ostensibly broadens the definition of national security and requires greater scrutiny by CFIUS of certain types of foreign direct investments. The law demonstrates the concern that some Members have with the way in which the Exon-Florio provision is administered. Some were also concerned with the perceived lack of transparency in the reviews that are mandated under the Exon-Florio provision, which some Members believe hampered Congress's ability to exercise its oversight responsibilities. Not all Members were satisfied with the law. Some Members argued that the law remained deficient in reviewing investment by foreign governments through sovereign wealth funds (SWFs), an issue that was attracting little attention when the law was adopted.

Members of Congress intended to have P.L. 110-49 address six perceived problems with the statutes as they existed that Members had identified. These concerns include (1) the principal members of the interagency Committee on Foreign Investment in the United States (CFIUS) at times seemed not to be well informed concerning the outcomes of reviews and investigations regarding proposed or pending investment transactions; (2) CFIUS had interpreted incorrectly the requirements under the statutes for investigations of transactions that involve firms that are owned or controlled by a foreign government; (3) reporting requirements had not provided Congress with enough information about the operations and actions of CFIUS for Members to fulfill their oversight responsibilities; (4) CFIUS had exercised too much discretion in choosing which transactions it investigated; (5) the definition of national security used by CFIUS was no longer adequate in a post-September 11th world; and (6) deadlines placed on CFIUS to complete reviews and investigations of investment transactions did not provide adequate time in some instances for the committee to complete its reviews and investigations. In early 2011, some Members of Congress had requested that the Obama Administration support a recommendation by CFIUS that the President block a proposed acquisition of 3Leaf Systems by Huawei Technologies over national security concerns. Instead, Huawei discontinued its efforts to acquire the U.S. firm.

The Exon-Florio Provision

In 1988, amid concerns over foreign acquisition of certain types of U.S. firms, particularly by Japanese firms, Congress passed and President Reagan signed the Omnibus Trade and Competitiveness Act of 1988.[5] The Exon-Florio provision, which was included as Section 5021 of that act, fundamentally transformed CFIUS. This statute grants the President the authority to block proposed or pending foreign "mergers, acquisitions, or takeovers" of "persons engaged in interstate commerce in the United States" that threaten to impair the national security. Congress directed, however, that before this authority can be invoked the President must conclude that other U.S. laws are inadequate or inappropriate to protect the national security, and that he must have "credible evidence" that the foreign investment will impair the national security. This same standard was maintained in P.L. 110-49.

Part of Congress's motivation in adopting the Exon-Florio provision apparently arose from concerns that foreign takeovers of U.S. firms could not be stopped unless the President declared a national emergency or regulators invoked federal antitrust, environmental, or securities laws. Through the Exon-Florio provision, Congress attempted to strengthen the President's hand in conducting foreign investment policy, while limiting its own role as a means of emphasizing that, as much as possible, the commercial nature of investment transactions should be free from political considerations. Congress also attempted to balance public concerns about the economic impact of certain types of foreign investment with the nation's long-standing international commitment to maintaining an environment that is open and receptive to foreign investment.

Furthermore, Congress did not intend to have the Exon-Florio provision alter the generally open foreign investment climate of the country or to have it inhibit foreign direct investments in industries that could not be considered to be of national security interest. At the time, some analysts believed the provision could potentially widen the scope of industries that fell under the national security rubric. CFIUS, however, is not free to establish an independent approach to

[5] P.L. 100-418, Title V, Subtitle A, Part II, or 50 U.S.C. app 2170.

reviewing foreign investment transactions, but operates under the authority of the President and reflects his attitudes and policies. As a result, the discretion CFIUS uses to review and to investigate foreign investment cases reflects policy guidance from the President. Foreign investors are also constrained by legislation that bars foreign direct investment in such industries as maritime, aircraft, banking, resources, and power.[6] Generally, these sectors were closed to foreign investors prior to passage of the Exon-Florio provision in order to prevent public services and public interest activities from falling under foreign control, primarily for national defense purposes.

During consideration of the Exon-Florio proposal, debate focused on three issues that generated a clash of views: (1) what constitutes foreign control of a U.S. firm?; (2) how should national security be defined?; and (3) which types of economic activities should be targeted for a CFIUS review? Of these issues, the most controversial and the most far-reaching was the lack of a definition of national security. As originally drafted, the provision would have considered investments which affected the "national security and essential commerce" of the United States. The term "essential commerce" was the focus of intense debate between Congress and the Reagan Administration.

The Treasury Department, headed by Secretary James Baker, objected to the Exon-Florio provision, and the Administration vetoed the first version of the Omnibus Trade legislation, in part due to its objections to the language in the measure regarding "national security and essential commerce." The Reagan Administration argued that the language would broaden the definition of national security beyond the traditional concept of military/defense to one which included a strong economic component. Administration witnesses argued against this aspect of the proposal and eventually succeeded in prodding Congress to remove the term "essential commerce" from the measure and in narrowing substantially the factors the President must consider in his determination. According to one participant, Congress placed the Exon-Florio provision in the statutes under Title VII of the Defense Production Act to indicate that the provision should be interpreted "as dealing with the broad industrial base issues addressed by that statute, not the more narrow national security controls dealt with in export control measures."[7]

Through Executive Order 12661, President Reagan implemented provisions of the Omnibus Trade Act. In the Executive Order, President Reagan delegated his authority to administer the Exon-Florio provision to CFIUS,[8] particularly to conduct reviews, to undertake investigations, and to make recommendations, although the statute itself does not specifically mention CFIUS. As a result of President Reagan's action, CFIUS was transformed from a purely administrative body with limited authority to review and analyze data on foreign investment to one with a broad mandate and significant authority to advise the President on foreign investment transactions and to recommend that some transactions be blocked.

[6] CRS Report RL33103, *Foreign Investment in the United States: Major Federal Statutory Restrictions*, by Michael V. Seitzinger.

[7] Ibid.

[8] Executive Order 12661 of December 27, 1988, 54 F.R. 779.

Treasury Department Regulations

After extensive public comment, the Treasury Department issued its final regulations in November 1991 implementing the Exon-Florio provision.[9] Although these procedures were amended through P.L. 110-49, they continued to serve as the basis for the Exon-Florio review and investigation until new regulations were released on November 21, 2008.[10] These regulations created an essentially voluntary system of notification by the parties to an acquisition and they allowed for notices of acquisitions by agencies that are members of CFIUS. Despite the voluntary nature of the notification, firms largely comply with the provision, because the regulations stipulate that foreign acquisitions that are governed by the Exon-Florio review process that do not notify the committee remain subject indefinitely to divestment or other appropriate actions by the President. The regulations make it clear that the President alone determines "whether a transaction threatens national security." Also, the regulations state that the Exon-Florio provision will not be interpreted narrowly in a way that might preclude the ability of CFIUS to review any transaction for its impact on national security. The Treasury Department, however, as the lead agency, indicated in the regulations that it would judge transactions to have "significant" importance for national security if they "involve products, services, and technologies that are important to U.S. national defense security requirements."[11] The regulations also indicate that notifications provided to the committee are considered to be confidential and the information is not released by the committee to the press or commented on publicly.

Transactions Not Subject to a Review

Another aspect of the regulations that has come under increased scrutiny due to the sharp runup in investments through sovereign wealth funds (SWFs) is the types of transactions that CFIUS generally will not subject to a national security review. According to Treasury Department regulations, investment transactions that are *not* considered transactions under the Exon-Florio provision and, therefore, not subject to a CFIUS review. Treasury regulations also stipulate that the extension of a loan or a similar financing arrangement by a foreign person to a U.S. business will not be considered a covered transaction and will not be investigated, unless the loan conveys a right to the profits of the U.S. business or involves a transfer of management decisions. The main provisions are:

> 1) An acquisition of voting securities pursuant to a stock split or pro rata stock dividend which does not involve a change in control.
>
> 2) An acquisition of any part of an entity or of assets that do not constitute a U.S. business.
>
> 3) An acquisition of securities by a person acting as a securities underwriter, in the ordinary course of business and in the process of underwriting.
>
> 4) An acquisition pursuant to a condition in a contract of insurance relating to fidelity, surety, or casualty obligations if the contract was made by an insurer in the ordinary course of business

[9] Regulations Pertaining to Mergers, Acquisitions, and Takeovers by Foreign Persons. 31 C.F.R. Part 800.

[10] 31 CFR Part 800, November 21, 2008.

[11] 31 CFR 800 Discussion of Final Rule.

> 5) An acquisition in which the parent of the entity making the acquisition is the same as the parent of the entity being acquired.
>
> 6) An acquisition of convertible voting securities that does not involve control.
>
> 7) A purchase of voting securities or comparable interests "solely for the purpose of investment," or an investment in which the foreign investor has "no intention of determining or directing the basic business decisions of the issuer." In addition, investments that are solely for investment purposes are defined as those: 1) in which the transaction does not involve owning more than 10% of the voting securities of the firm; or 2) those investments that are undertaken directly by a bank, trust company, insurance company, investment company, pension fund, employee benefit plan, mutual fund, finance company, or brokerage company "in the ordinary course of business for its own account."[12]

Foreign investors representing SWFs invested heavily in the mid to late 2000s in U.S. financial institutions ranging from NASDAQ to Morgan Stanley, Merrill Lynch, and Citigroup as a number of these financial institutions experienced a drop in the value of assets associated with the sub-prime mortgage crisis. In some cases, the foreign investments have accounted for less than 10% of the voting securities of the firm and were classified as investments only for the purpose of investment apparently to avoid a CFIUS review or investigation.

Control

A key factor in the Exon-Florio process is applying the term "control" to evaluating the role of a foreign investor in any proposed transaction. While the statute does not provide a definition of this term, a definition is included in the Treasury Department's regulations. According to those regulations, control is not defined as a numerical benchmark,[13] but instead focuses on a functional definition of the term, or a definition that is governed by the influence the level of ownership permits the foreign entity to affect certain decisions by the firm. According to the Treasury Department's regulations:

> The term control means the power, direct or indirect, whether or not exercised, and whether or not exercised or exercisable through the ownership of a majority or a dominant minority of the total outstanding voting securities of an issuer, or by proxy voting, contractual arrangements or other means, to determine, direct or decide matters affecting an entity; in particular, but without limitation, to determine, direct, take, reach or cause decisions regarding:
>
> (1) The sale, lease, mortgage, pledge or other transfer of any or all of the principal assets of the entity, whether or not in the ordinary course of business;

[12] 31 CFR 800.302.

[13] There are other statutes that do use numerical benchmarks. According to Section 13(d) of the Securities Exchange Act of 1934 (15 U.S.C. §78m(d) any person who acquires 5% or more of the publicly traded securities of a U.S. firm must report the acquisition of the shares to the Securities and Exchange Commission. For statistical purposes, the United States defines foreign direct investment as the ownership or control, directly or indirectly, by one foreign person (individual, branch, partnership, association, government, etc.) of 10% or more of the voting securities of an incorporated U.S. business enterprise or an equivalent interest in an unincorporated U.S. business enterprise 15 CFR § 806.15 (a)(1). This level of ownership requires foreign owners to file quarterly and longer annual reports with the Department of Commerce as part of the quarterly and annual reports on the balance of payments and gross domestic product (GDP).

(2) The reorganization, merger, or dissolution of the entity;

(3) The closing, relocation, or substantial alteration of the production, operational, or research and development facilities of the entity;

(4) Major expenditures or investments, issuances of equity or debt, or dividend payments by this entity, or approval of the operating budget of the entity;

(5) The selection of new business lines or ventures that the entity will pursue;

(6) The entry into termination or non-fulfillment by the entity of significant contracts;

(7) The policies or procedures of the entity governing the treatment of non-public technical, financial, or other proprietary information of the entity;

(8) The appointment or dismissal of officers or senior managers;

(9) The appointment or dismissal of employees with access to sensitive technology or classified U.S. Government information; or

(10) The amendment of the Articles of Incorporation, constituent agreement, or other organizational documents of the entity with respect to the matters described at paragraph (a) (1) through (9) of this section.

National Security

Neither Congress nor the Administration have attempted to define the term national security as it appears in the Exon-Florio statute. Treasury Department officials have indicated, however, that during a review or investigation each member of CFIUS is expected to apply that definition of national security that is consistent with the representative agency's specific legislative mandate.[14] The concept of national security was broadened by P.L. 110-49 to include "those issues relating to 'homeland security,' including its application to critical infrastructure," and "critical technologies."

The Treasury Department provides some guidance through its regulations to firms that are deciding whether they should notify CFIUS of a proposed or pending merger, acquisition, or takeover. The guidance states that proposed acquisitions that need to notify CFIUS are those that involve "products or key technologies essential to the U.S. defense industrial base." This notice is not intended for firms that produce goods or services with no special relation to national security, especially toys and games, food products, hotels and restaurants, or legal services. CFIUS has indicated that in order to assure an unimpeded inflow of foreign investment it would implement the statute "only insofar as necessary to protect the national security," and "in a manner fully consistent with the international obligations of the United States."[15]

[14] Senate Armed Services Committee, Briefing on the Dubai Ports World Ports Deal, February 23, 2006.

[15] Ibid.

The "Byrd Amendment"

In 1992, Congress amended the Exon-Florio statute through Section 837(a) of the National Defense Authorization Act for Fiscal Year 1993 (P.L. 102-484). Known as the "Byrd" amendment after the amendment's sponsor, the provision requires CFIUS to investigate proposed mergers, acquisitions, or takeovers in cases where two criteria are met:

> (1) the acquirer is controlled by or acting on behalf of a foreign government; and
>
> (2) the acquisition results in control of a person engaged in interstate commerce in the United States that could affect the national security of the United States.[16]

This amendment came under intense scrutiny by the 109th Congress as a result of the DP World transaction. Many Members of Congress and others believed that this amendment required CFIUS to undertake a full 45-day investigation of the transaction because DP World was "controlled by or acting on behalf of a foreign government." The DP World acquisition, however, exposed a sharp rift between what some Members apparently believed the amendment directed CFIUS to do and how the members of CFIUS are interpreting the amendment. In particular, some Members of Congress apparently interpreted the amendment to direct CFIUS to conduct a mandatory 45-day investigation if the foreign firm involved in a transaction is owned or controlled by a foreign government. Representatives of CFIUS have argued that they interpret the amendment to mean that a 45-day investigation is discretionary and not mandatory. In the case of the DP World acquisition, CFIUS representatives argued that they had concluded as a result of an extensive review of the proposed acquisition prior to the case being formally filed with CFIUS and during the 30-day review that the DP World case did not warrant a full 45-day investigation. They conceded that the case met the first criterion under the Byrd amendment, because DP World was controlled by a foreign government, but that it did not meet the second part of the requirement, because CFIUS had concluded during the 30-day review that the transaction "could not affect the national security."[17]

The intense public and congressional reaction that arose from the proposed Dubai Ports World acquisition spurred the Bush Administration in late 2006 to make an important administrative change in the way CFIUS reviews foreign investment transactions. CFIUS and President Bush approved the acquisition of Lucent Technologies, Inc. by the French-based Alcatel SA, which was completed on December 1, 2006. Before the transaction was approved by CFIUS, however, Alcatel-Lucent was required to agree to a national security arrangement, known as a Special Security Arrangement, or SSA, that restricts Alcatel's access to sensitive work done by Lucent's research arm, Bell Labs, and the communications infrastructure in the United States.

The most controversial feature of this arrangement is that it allows CFIUS to reopen a review of the deal and to overturn its approval at any time if CFIUS believes the companies "materially fail to comply" with the terms of the arrangement. This marks a significant change in the CFIUS process. Prior to this transaction, CFIUS reviews and investigations had been portrayed, and had been considered, to be final. As a result, firms were willing to subject themselves voluntarily to a CFIUS review, because they believed that once an investment transaction was scrutinized and

[16] P.L. 102-484, October 23, 1992.

[17] Briefing on the Dubai Ports World Deal before the Senate Armed Services Committee, February 23, 2006.

approved by the members of CFIUS the firms could be assured that the investment transaction would be exempt from any future reviews or actions. This administrative change, however, means that a CFIUS determination may no longer be a final decision and it adds a new level of uncertainty to foreign investors seeking to acquire U.S. firms. A broad range of U.S. and international business groups are objecting to this change in the Administration's policy.[18]

The Amended CFIUS Process

In the first session of the 110th Congress, Representative Maloney introduced H.R. 556, the National Security Foreign Investment Reform and Strengthened Transparency Act of 2007, on January 18, 2007. The measure was approved by the House Financial Services Committee on February 13, 2007, with amendments, and was approved with additional amendments by the full House on February 28, 2007, by a vote of 423 to 0. On June 13, 2007, Senator Dodd introduced S. 1610, the Foreign Investment and National Security Act of 2007. On June 29, 2007, the Senate adopted S. 1610 in lieu of H.R. 556 by unanimous consent. On July 11, 2007, the House accepted the Senate's version of H.R. 556 by a vote of 370-45 and sent the measure to the President, who signed it on July 26, 2007. It is designated as P.L. 110-49. On January 23, 2008, President Bush issued Executive Order 13456 implementing the law. The Executive Order makes a number of substantive changes to the law. This report incorporates the changes made by this statute and by the Executive Order.

P.L. 110-49 establishes CFIUS by statutory authority and has the Secretary of the Treasury serve as the chairman of CFIUS. The measure follows the same pattern that was set by Executive Order by allotting the committee 30 days to conduct a review, 45 days to conduct an investigation, and 15 days for the President to make his determination. The President retains his authority as the only officer with the authority to suspend or prohibit mergers, acquisitions, and takeovers, and the measure places additional requirements on firms that resubmitted a filing after previously withdrawing a filing before a full review could be completed.

Over time, the three-step Exon-Florio process apparently had evolved to include an informal stage of unspecified length that consisted of an unofficial CFIUS determination prior to the formal filing with CFIUS. This type of informal review developed because it likely served the interests of both CFIUS and the firms that were involved in an investment transaction. According to Treasury Department officials, this informal contact enabled "CFIUS staff to identify potential issues before the review process formally begins."[19] This informal process is likely to continue under the provisions of P.L. 110-49.

Firms that are party to an investment transaction apparently have benefitted from this informal review in a number of ways. For one, it allowed firms additional time to work out any national security concerns privately with individual CFIUS members. Secondly, and perhaps more importantly, it provided a process for firms to avoid risking potential negative publicity that could arise if a transaction were to be blocked or otherwise labeled as impairing U.S. national security

[18] Kirchgaessner, Stephanie, "US Threat to Reopen Terms of Lucent and Alcatel Deal Mergers," *Financial Times*, December 1, 2006. P. 19; Pelofsky, Jeremy, "Businesses Object to US move on foreign Investment," *Reuters News*, December 5, 2006.

[19] Testimony of Robert Kimmett, Briefing on the Dubai Ports World Deal Before the Senate Armed Services Committee, February 23, 2006.

interests. For some firms, public knowledge of a CFIUS investigation has had a negative effect on the value of the firm's stock price.

After a lengthy review by CFIUS in 2000, Verio, Inc., a U.S. firm that operates websites for businesses and provides internet services, was acquired by NTT Communications of Japan. Verio's stock price reportedly fell during the CFIUS investigation as a result of uncertainty in the market about prospects for the transaction. The CFIUS review was instigated by the FBI, which had expressed concerns during the initial review stage that the majority interest of the Japanese government in NTT could give it access to information regarding wiretaps that were being conducted on email and other Web-based traffic crossing Verio's computer system. After completing its investigation, however, CFIUS did not recommend that President Clinton block the transaction.

The potentially negative publicity that can be associated with a CFIUS investigation of a transaction apparently has had a major impact on the transactions CFIUS has investigated. Since 1990, nearly half of the transactions CFIUS investigated were terminated by the firms involved, because the firms decided to withdraw from the transactions rather than face a negative determination by CFIUS. In 2006, for instance, the prospect of a CFIUS investigation apparently was the major reason the Israeli firm Check Point Software Technologies decided to call off its proposed $225 million acquisition of Sourcefire, a U.S. firm specializing in security appliances for protecting a corporation's internal computer networks. In addition, the decision by the China National Offshore Oil Company (CNOOC) to drop its proposed acquisition of Unocal oil company in 2005 was partly due to concerns by CNOOC about an impending CFIUS investigation of the transaction.

Between December 2009 and July 2010, two Chinese firms withdrew their proposed acquisitions of U.S. firms due to opposition from at least one CFIUS agency. In December 2009, the Chinese firm Northwest Nonferrous International Investment Corp., a subsidiary of China's largest aluminum producer, attempted to acquire U.S.-based Firstgold due to objections by the U.S. Department of the Treasury that Firstgold had properties near sensitive military bases. In June 2010, China's Tangshan Caofedian Investment Corporation withdrew its proposed acquisition of Emcore, which makes components for fiber optics and solar panels due to "regulatory concerns."[20] As previously indicated, in early 2011, CFIUS recommended that President Obama block a proposed acquisition of 3Leaf Systems by Huawei Technologies unless Huawei agreed to restructure its proposed acquisition. Initially, Huawei indicated that it would appeal its case to the President, but eventually decided to drop its proposed acquisitions.

On September 29, 2012, President Obama used authority granted to him under the Exon-Florio provision and P.L. 110-49 to direct the Chinese-owned Ralls Corporation to divest itself of four wind turbine project companies in Boardman, Oregon, that were in or within the vicinity of restricted air space at a Naval Weapons Systems Training Facility. Ralls Corporation had failed to notify CFIUS of the acquisition in early 2012 and subsequent negotiations with CFIUS had failed to devise a mitigation agreement that was satisfactory to both CFIUS and Ralls. Under the investment, the Chinese firm planned to install wind turbines manufactured by Sany Corporation in China. Ralls had filed a suit against CFIUS claiming that CFIUS had been arbitrary and capricious in its treatment of Ralls. That suit, however, was made moot by President Obama's decision.

[20] Kirchgaessner, Stephanie, "US Blocks China Fibre Optics Deal Over Security," *Financial Times*, June 30, 2010.

For CFIUS members, the informal process was beneficial because it gave them as much time as they have felt was necessary to review a transaction without facing the time constraints that arise under the formal CFIUS review process. This informal review likely also gave the CFIUS members added time to negotiate with the firms involved in a transaction to restructure the transaction in ways that could have addressed any potential security concerns or to develop other types of conditions that members felt are appropriate in order to remove security concerns.

On January 23, 2008, President Bush issued Executive Order 13456, which implemented P.L. 110-49 and made various changes to the law. The Treasury Department finalized its regulations implementing the law on November 21, 2008.[21] Presently, the committee consists of nine members, including the Secretaries of State, the Treasury, Defense, Homeland Security, Commerce, and Energy; the Attorney General; the United States Trade Representative; and the Director of the Office of Science and Technology.[22] The Secretary of Labor and the Director of National Intelligence serve as ex officio members of the committee.[23] Executive Order 13456 also added five more members to CFIUS in order to "observe and, as appropriate, participate in and report to the President." These members include the Director of the Office of Management and Budget, the Chairman of the Council of Economic Advisors, The Assistant to the President for National Security Affairs, the Assistant to the President for Economic Policy, and the Assistant to the President for Homeland Security and Counterterrorism. The President can also appoint temporary members to the committee as he determines.

The law now requires CFIUS to review all "covered" foreign investment transactions to determine whether (1) a transaction threatens to impair the national security; (2) the foreign entity is controlled by a foreign government; or (3) the transaction would result in control of any "critical infrastructure that could impair the national security." A covered foreign investment transaction is defined as any merger, acquisition, or takeover which results in "foreign control of any person engaged in interstate commerce in the United States." As previously indicated, the Treasury Department's regulations exclude certain types of transactions from being classified as covered transactions and, therefore, not subject to a CFIUS review. Such transactions are specified as those that are undertaken "solely for the purpose of investment," or an investment in which the foreign investor has "no intention of determining or directing the basic business decisions of the issuer."

[21] 31 CFR Part 800, November 21, 2008*; Federal Register*, November 21, 2008, p. 70702.

[22] The United States Trade Representative and the Director of the Office of Science and Technology were added through E.O. 13456, issued January 23, 2008.

[23] Executive Order 11858 of May 7, 1975, 40 F.R. 20263 established the committee with six members: the Secretaries of State, the Treasury, Defense, Commerce, and the Assistant to the President for Economic Affairs, and the Executive Director of the Council on International Economic Policy. Executive Order 12188, January 2, 1980, 45 F.R. 969, added the United States Trade Representative and substituted the Chairman of the Council of Economic Advisors for the Executive Director of the Council on International Economic Policy. Executive Order 12661, December 27, 1988, 54 F.R. 779, added the Attorney General and the Director of the Office of Management and Budget. Executive Order 12860, September 3, 1993, 58 F.R. 47201, added the Director of the Office of Science and Technology Policy, the Assistant to the President for National Security Affairs, and the Assistant to the President for Economic Policy. Executive Order 13286, Section 57, February 28, 2003, added the Secretary of Homeland Security. P.L. 110-49 reduced the membership of CFIUS to six Cabinet members and the Attorney General, it added the Secretary of Labor and the Director of National Security as ex officio members, and removed seven White House appointees.

Critical Infrastructure

A new element to the Exon-Florio process that was added by P.L. 110-49 is the addition of "critical industries" and "homeland security" as broad categories of economic activity that could be subject to a CFIUS national security review. Arguably, the events of September 11, 2001, reshaped congressional attitudes toward the Exon-Florio provision. This change became apparent in 2006 following the public disclosure that Dubai Ports World[24] was attempting to purchase the British-owned P&O Ports,[25] with operations in various U.S. ports. After the September 11th terrorist attacks Congress passed and President Bush signed the USA PATRIOT Act of 2001 (Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism).[26] In this act, Congress provided for special support for "critical industries," which it defined as:

> systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems and assets would have a debilitating impact on security, national economic security, national public health or safety, or any combination of those matters.[27]

This broad definition is enhanced to some degree by other provisions of the act, which identify certain sectors of the economy that are likely candidates for consideration as components of the national critical infrastructure. These sectors include telecommunications, energy, financial services, water, transportation sectors,[28] and the "cyber and physical infrastructure services critical to maintaining the national defense, continuity of government, economic prosperity, and quality of life in the United States."[29] The following year, Congress adopted the language in the Patriot Act on critical infrastructure into The Homeland Security Act of 2002.[30]

By adopting the terms "critical infrastructure" and "homeland security," following the events of September 11, 2001, Congress demonstrated that the attacks had fundamentally altered the way many in Congress viewed the concept of national security. As a result, some policymakers in Congress and elsewhere concluded that economic activities are a separately identifiable component of national security and, therefore, should be protected from foreign investment that transfers control to foreigners or shifts technological leadership abroad. This viewpoint, however, was not shared by some policymakers within the Bush Administration, who argued that including critical infrastructure and homeland security in P.L. 110-49 did not alter the overriding focus of the Exon-Florio provision on investments that directly affect U.S. national defense security. In P.L. 110-49, critical infrastructure is defined 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." As a result, Congress and the various

[24] Dubai Ports World was created in November 2005 by integrating Dubai Ports Authority and Dubai Ports International. It is one of the largest commercial port operators in the world with operations in the Middle East, India, Europe, Asia, Latin America, the Caribbean, and North America.

[25] Peninsular and Oriental Steam Company is a leading ports operator and transport company with operations in ports, ferries, and property development. It operates container terminals and logistics operations in over 100 ports and has a presence in 18 countries.

[26] P.L. 107-56, Title X, §1014, October 26, 2001; 42 U.S.C. §5195c(e).

[27] Ibid.

[28] 42 U.S.C. §5195c(b)(2).

[29] 42 U.S.C. §5195c(b)(3).

[30] 6 U.S.C. §101(4).

administrations have sparred at times over transactions that CFIUS has approved over the objections of various Members of Congress. Some of these cases include the following:

> In May 2007, GE and Saudi Basic Industries Corporation (SABIC) announced that SABIC would acquire GE Plastics for $11.6 billion. GE intended to use the proceeds from the sale to buy back a large amount of its own stock to finance other projects and to improve its stock price. SABIC, which is 70% owned by the Saudi Government, is the largest public company in the Middle East and one of the 10 largest petrochemical manufacturers in the world. Some in Congress objected to the acquisition because GE Plastics produces products that have important defense applications, including such bullet resistant and bomb blast shielding products as Armorgard, Suregard and Lexgard laminates. After a CFIUS review yielded no opposition to the transaction, the acquisition was completed.
>
> On November 27, 2007, Citigroup Inc. and the Abu Dhabi Investment Company (ADIC) announced that ADIC would acquire 4.9% of Citigroup's shares for an investment of $7.5 billion. The Abu Dhabi-Citigroup investment transaction involves a complex exchange of cash and stock. For $7.5 billion, Citigroup will sell ADIA between 201 million and 235 million shares of Citigroup stock, depending on the value of Citigroup's stock at the predesignated time periods, at an interest rate of 11.00% on a complex hybrid security that is comprised of mandatory convertible shares, which consist of a contract to purchase stock at different purchase dates, and the payment of interest on each series of preferred securities and a payment on the purchase contracts. The Abu Dhabi investment entity has stated that its interests are purely economic and that it will have no role in the management or the governance of Citigroup nor any presence on its board.[31]
>
> On September 28, 2007, 3Com Corporation announced that it had agreed to be acquired by Bain Capital Partners for $2.2 billion, or $5.30 per share. Bain Capital, is a privately-held asset management and investment firm, and Huawei Technologies is the largest networking and telecommunications equipment supplier in China. 3Com is a publicly held company that specializes in networking equipment and in the Tipping Point network intrusion prevention software. Such software is used by various U.S. defense firms to prevent outside groups from accessing their confidential databases. In 2003, 3Com formed a joint venture with Huawei Technologies, known as Huawei-3Com, to manufacture routers and switches for internet and broadband uses. In November 2006, 3Com acquired the half of Huawei-3Com that it did not own for $822 million. As part of the most recent transaction, affiliates of Huawei Technologies would have acquired a minority interest in 3Com and would have become a commercial and strategic partner of 3Com. On February 20, 2008, Bain Capital and Huawei Technologies withdrew their offer to acquire 3Com, due to an inability to successfully negotiate a mitigation agreement with members of CFIUS. Bain Capital and Huawei reportedly will restructure the deal and resubmit it at a later date in 2008.[32]

Some policymakers also perceive greater risks to the economy rising from foreign investments in which the foreign investor is owned or controlled by foreign governments as a result of the terrorist attacks. The Dubai Ports World case, in particular, demonstrated that there was a difference between the post-September 11 expectations held by many in Congress about the role of foreign investment in the economy and of economic infrastructure issues as a component of national security. For some Members of Congress, CFIUS has seemed out of touch with the post-September 11, 2001, view of national security, because it remains founded in the late 1980s

[31] Timmons, Heather, and Julia Werdigier, "For Abu Dhabi and Citi, Credit Crisis Drove Deal," *The New York Times,* November 28, 2007.

[32] "US Insiders Point to Bain Errors Over 3Com," *The Financial Times Limited*, march 3, 2008.

orientation of the Exon-Florio provision, which views national security primarily in terms of national defense and downplays or even excludes a broader notion of economic national security.

Between December 2009 and July 2010, two Chinese firms withdrew their proposed acquisitions of U.S. firms due to opposition from at least one CFIUS agency. In December 2009, the Chinese firm Northwest Nonferrous International Investment Corp., a subsidiary of China's largest aluminum producer, attempted to acquire U.S.-based Firstgold due to objections by the U.S. Department of the Treasury that Firstgold had properties near sensitive military bases. In June 2010, China's Tangshan Caofedian Investment Corporation withdrew its proposed acquisition of Emcore, which makes components for fiber optics and solar panels, due to "regulatory concerns."[33]

In 2012, two investments by Chinese firms attracted public and congressional attention: an investment by the Chinese firm Sany Group in a wind farm project, known as the Butter Creek Projects, in Oregon by Ralls Corp.; and Wanxiang's acquisition of battery-maker A123 Systems Inc. In March 2012, Ralls acquired the wind farm assets from Terna Energy SA, an Athens, Greece-based company, without reporting the transaction to CFIUS. In June, 2012, CFIUs contacted Ralls and requested the firm file a voluntary notification to have its investment retroactively reviewed. After reviewing the acquisition, CFIUS recommended that Ralls stop operations until a complete investigation could be completed as a result of objections by the U.S. Navy over the placement of wind turbines by Ralls near or within restricted Naval Weapons Systems Training Facility airspace where drones (unmanned aerial vehicles) are tested. After a full investigation, CFIUS recommended that President Obama block the investment by ordering a divestment of the transaction and imposed other requirements on Ralls to remove equipment it had installed.

On September 28, 2012, President Obama issued an executive order[34] that argued that there was credible evidence that the Ralls acquisition threatened to impair U.S. national security and ordered Ralls to divest itself of the Oregon wind farm project. In response, the Ralls Corporation filed a suit on October 1, 2012, challenging the Obama Administration's authority to block the investment. On February 22, 2013, the United States District Court for the District of Columbia dismissed the suit by ruling that the court lacked jurisdiction, since the CFIUS statute states that the President's decisions are not subject to judicial review, known as a finality provision.[35] Ralls argued that the President was authorized only to "suspend or prohibit" a transaction, not to order a removal of equipment or a divesture.

The court ruled, however, that the statute grants the President broad authority by authorizing him to take "such action for such time" as he considers appropriate. The suit also argued that Ralls was treated unfairly under the Due Process Clause of the Fifth Amendment, but the court ruled that it lacked jurisdiction on this motion as well by the CFIUS statute. Nevertheless, the court indicated that its ruling would not prohibit Ralls' due process claim to proceed. The Ralls' due process claim apparently focused on whether the President and/or CFIUS should be required to

[33] Kirchgaessner, Stephanie, US Blocks China Fibre Optics Deal Over Security, *Financial Times*, June 30, 2010.

[34] Order Signed by the President Regarding the Acquisition of Four U.S. Wind Farm Project Companies by Ralls Corporation, The White House, September 28, 2012. Available at: http://www.whitehouse.gov/the-press-office/2012/09/28/order-signed-president-regarding-acquisition-four-us-wind-farm-project-c.

[35] Ralls Corporation vs. Committee on Foreign Investment in the United States, et al., Civil Action Number 12-1513; available at: https://ecf.dcd.uscourts.gov/cgi-bin/show_public_doc?2012cv1513-46.

provide companies that proceed through the CFIUS review and investigation process with an opportunity to review, respond to, and rebut any evidence used to make a Presidential Determination. One issue involved in requiring access to such information is the fact that CFIUS's analysis for any particular transaction is based on classified information that generally is not available to the public. Ralls has appealed the case.

In another case, China's Wanxiang Group received approval in January 2013 from CFIUS to acquire electric car battery maker A123 Systems. Wanxiang outbid other potential buyers by offering to pay $257 million for the U.S. company. Some Members of Congress and the Strategic Materials Advisory Council argued against the acquisitions on the grounds that it could jeopardize the nation's energy security. Others opposed the acquisition because A123 Systems had received nearly $250 million in a federal grant to support clean energy, although half of the grant was never released. A123 Systems manufactures lithium-ion batteries for Fisker Automotive, BMW hybrid 3- and 5-series cars, and the all-electric Chevrolet Spark.

Procedures

According to the amended Exon-Florio provision, the President or any member of CFIUS can initiate a review of an investment transaction in addition to a review that is initiated by the parties to a transaction providing a formal notification. As amended, CFIUS has 30 days to review a transaction to decide after it receives the initial formal notification by the parties to a merger, acquisition, or a takeover, whether to investigate a case as a result of its determination that the investment "threatens to impair the national security of the United States." National security also includes "those issues relating to 'homeland security,' including its application to critical infrastructure." In addition, CFIUS is required to conduct an investigation of a transaction if the committee determines that the transaction would result in foreign control of any person engaged in interstate commerce in the United States. During such a review, the members of CFIUS are also required to consider the 12 factors that Congress has authored as a basis for assessing the impact of the investment. If during this 30-day period all of the members of CFIUS conclude that the investment does not threaten to impair the national security, the review is terminated. If, however, at least one member of the committee determines that the investment does threaten to impair the national security, CFIUS can proceed to a 45-day investigation.

During the 30-day review stage, the Director of National Intelligence, although not a member of CFIUS, is required to carry out a thorough analysis of "any threat to the national security of the United States" of any merger, acquisition, or takeover. This analysis is required to be completed "within 20 days" of the receipt of a notification by CFIUS, but the statute directs that the DNI must be given "adequate time," presumably if this national security review cannot be completed within the 20-day requirement. This analysis would include a request for information from the Department of the Treasury's Director of the Office of Foreign Assets Control and the Director of the Financial Crimes Enforcement Network. In addition, the Director of National Intelligence is required to seek and to incorporate the views of "all affected or appropriate" intelligence agencies.

CFIUS is also required to review "covered" investment transactions in which the foreign entity is owned or controlled by a foreign government, but the law provides an exception to this requirement. A review is exempted if the Secretary of the Treasury and certain other specified officials determine that the transaction in question will not impair the national security. It is somewhat unclear, however, how this requirement is meshing with the established process. The measure does not amend or alter the current statute in the area that has been the source of

differences between CFIUS and Congress. In particular, the current statute states that the President, and through him CFIUS, can use the Exon-Florio process "only if" he finds that there is "credible evidence" that a foreign investment will impair national security. As a result, if CFIUS determines, as was the case in the Dubai Ports transaction, that it does not have credible evidence that an investment will impair the national security, then it argues that it is not required to undertake a full 45-day investigation, even if the foreign entity is owned or controlled by a foreign government.

During a review or an investigation, CFIUS and a designated lead agency have the authority to negotiate, impose, or enforce any agreement or condition with the parties to a transaction in order to mitigate any threat to the national security of the United States. Such agreements are to be based on a "risk-based analysis" of the threat posed by the transaction. Also, if a notification of a transaction is withdrawn before any review or investigation by CFIUS can be completed, the amended law grants the committee the authority to take a number of actions. In particular, the committee could develop (1) interim protections to address specific concerns about the transaction pending a re-submission of a notice by the parties; (2) specific time frames for re-submitting the notice; and (3) a process for tracking any actions taken by any parties to the transaction.

Presidential Authority

As previously indicated, P.L. 110-49 grants the President the authority to block proposed or pending foreign "mergers, acquisitions, or takeovers" of "persons engaged in interstate commerce in the United States" that threaten to impair the national security. Congress directed that before this authority can be invoked the President must (1) conclude that other U.S. laws are inadequate or inappropriate to protect the national security; and (2) have "credible evidence" that the foreign investment will impair the national security. As a result, if CFIUS determines, as was the case in the Dubai Ports transaction, that it does not have credible evidence that an investment will impair the national security, then it argues that it is not required to undertake a full 45-day investigation, even if the foreign entity is owned or controlled by a foreign government. After considering the two conditions listed above (other laws are inadequate or inappropriate, and he has credible evidence that a foreign transaction will impair national security), the President is granted almost unlimited authority to take "**such action for such time as the President considers appropriate to suspend or prohibit any covered transaction that threatens to impair the national security of the United States**." In addition, such determinations by the President are not subject to judicial review, as was emphasized in the ruling by the U.S. District Court for the District of Columbia in the case of *Ralls vs. the Committee on Foreign Investment in the United States*.

In addition, the President, acting through CFIUS, is required to conduct a National Security investigation and to take any "necessary" actions as part of the 45-day investigation if the review indicates that at least one of three conditions exists. These three conditions are (1) as a result of a review of the transaction, CFIUS determines that the transactions threaten to impair the national security of the United States and that the threat had not been mitigated during or prior to a review of the transaction; (2) the foreign person is controlled by a foreign government; or (3) the transactions would result in the control of any critical infrastructure by a foreign person, the transactions could impair the national security, and that such impairment had not been mitigated. At the conclusion of the investigation or the 45-day review period, whichever comes first, the committee can decide to offer no recommendation or it can recommend that the President

suspend or prohibit the investment. The President is under no obligation to follow the recommendation of the committee to suspend or prohibit an investment.

During a review or an investigation, CFIUS and a designated lead agency have the authority to negotiate, impose, or enforce any agreement or condition with the parties to a transaction in order to mitigate any threat to the national security of the United States. Such agreements are to be based on a "risk-based analysis" of the threat posed by the transaction. Also, if a notification of a transaction is withdrawn before any review or investigation by CFIUS can be completed, the amended law grants the committee the authority to take a number of actions. In particular, the committee could develop (1) interim protections to address specific concerns about the transaction pending a re-submission of a notice by the parties; (2) specific time frames for re-submitting the notice; and (3) a process for tracking any actions taken by any parties to the transaction.

Factors for Consideration

The Exon-Florio provision includes a list of 12 factors the President must consider in deciding to block a foreign acquisition. These factors are also considered by the individual members of CFIUS as part of their own review process to determine if a particular transaction threatens to impair the national security. This list includes the following elements:

> (1) domestic production needed for projected national defense requirements;
>
> (2) 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;
>
> (3) 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;
>
> (4) the potential effects of the transactions on the sales of military goods, equipment, or technology to a country that supports terrorism or proliferates missile technology or chemical and biological weapons; and transactions identified by the Secretary of Defense as "posing a regional military threat" to the interests of the United States;
>
> (5) the potential effects of the transaction on U.S. technological leadership in areas affecting U.S. national security;
>
> (6) whether the transaction has a security-related impact on critical infrastructure in the United States;
>
> (7) the potential effects on United States critical infrastructure, including major energy assets;
>
> (8) the potential effects on United States critical technologies;
>
> (9) whether the transaction is a foreign government-controlled transaction;
>
> (10) in those cases involving a government-controlled transaction, a review of (A) the adherence of the foreign country to nonproliferation control regimes, (B) the foreign country's record on cooperating in counter0terrorism efforts, (C) the potential for transshipment or diversion of technologies with military applications;

> (11) the long-term projection of the United States requirements for sources of energy and other critical resources and materials; and
>
> (12) such other factors as the President or the committee determine to be appropriate.[36]

Factors 6-12 were added through P.L. 110-49 and potentially broaden significantly the scope of CFIUS's reviews and investigations. Previously, CFIUS had been directed by Treasury Department regulations to focus its activities primarily around investments that had an impact on U.S. national defense security. The additional factors, however, incorporate economic considerations into the Exon-Florio process in a way that was specifically rejected when the measure initially was adopted and refocuses CFIUS's reviews and investigations to consider the broader rubric of economic security. In particular, CFIUS is now required to consider the impact of an investment on critical infrastructure as a factor for considering recommending that the President block or postpone a transaction. Critical infrastructure is defined in broad terms within the measure as "any systems and assets, whether physical or cyber-based, so vital to the United States that the degradation or destruction of such systems or assets would have a debilitating impact on national security, including national economic security and national public health or safety."

As originally drafted, the Exon-Florio provision also would have applied to joint ventures and licensing agreements in addition to mergers, acquisitions, and takeovers. Joint ventures and licensing agreements subsequently were dropped from the proposal because the Reagan Administration and various industry groups argued at the time that such business practices were deemed to be beneficial arrangements for U.S. companies. In addition, they argued that any potential threat to national security could be addressed by the Export Administration Act[37] and the Arms Control Export Act.[38]

Confidentiality Requirements

The Exon-Florio provision also codified confidentiality requirements that are similar to those that appeared in Executive Order 11858 by stating that any information or documentary material filed under the provision may not be made public "except as may be relevant to any administrative or judicial action or proceeding."[39] The provision does state, however, that this confidentiality provision "shall not be construed to prevent disclosure to either House of Congress or to any duly authorized committee or subcommittee of the Congress." The provision provides for the release of proprietary information "which can be associated with a particular party" to committees only with assurances that the information will remain confidential. Members of Congress and their staff members will be accountable under current provisions of law governing the release of certain types of information. The Exon-Florio provision requires the President to provide a written report to the Secretary of the Senate and the Clerk of the House detailing his decision and his actions relevant to any transaction that was subject to a 45-day investigation.[40]

[36] The last requirement under factor 4 and factors 6-12 were added by P.L. 110-49.

[37] 50 U.S.C. App. §2401, as amended.

[38] 22 U.S.C. App. 2778 et seq.

[39] 50 U.S.C. Appendix §2170(c).

[40] 50 U.S.C. Appendix §2170(g).

Mitigation and Tracking

Following the implementation of the Exon-Florio provision in the 1980s, CFIUS had developed several informal practices that likely were not envisioned when the statute was drafted. In particular, members of CFIUS on occasion had negotiated conditions with firms to mitigate or to remove business arrangement that raised national security concerns among the members of CFIUS. Such agreements often were informal arrangements that had an uncertain basis in statute and had not been tested in court. These arrangements often were negotiated during the formal 30-day review period, or even during an informal process prior to the formal filing of a notice of an investment transaction.

Presently, CFIUS must designate a lead agency to negotiate, modify, monitor, and enforce agreements in order to mitigate any threat to national security. Such agreements are required to be based on a "risk-based analysis" of the threat posed by the transaction. CFIUS is also required to develop a method for evaluating the compliance of firms that have entered into a mitigation agreement or condition that was imposed as a requirement for approval of the investment transaction. Such measures, however, are required to be developed in such a way that they allow CFIUS to determine that compliance is taking place without also (1) "unnecessarily diverting" CFIUS resources from assessing any new covered transaction for which a written notice had been filed; and (2) placing "unnecessary" burdens on a party to an investment transaction.

If a notification of a transaction is withdrawn before any review or investigation by CFIUS can be completed, CFIUS can take a number of actions, including (1) interim protections to address specific concerns about the transaction pending a re-submission of a notice by the parties; (2) specific time frames for re-submitting the notice; and (3) a process for tracking any actions taken by any party to the transaction. Also, any federal entity or entities that are involved in any mitigation agreement are to report to CFIUS if there is any modification that is made to any agreement or condition that had been imposed and to ensure that "any significant" modification is reported to the Director of National Intelligence and to any other federal department or agency that "may have a material interest in such modification." Such reports are required to be filed with the Attorney General.

Congressional Oversight

P.L. 110-49 significantly increased the types and number of reports that CFIUS is required to send to certain specified Members of Congress. In particular, CFIUS is required to brief certain congressional leaders if they request such a briefing and to report annually to Congress on any reviews or investigations that it had conducted during the prior year. Each report must include a list of all reviews and investigations that had been conducted, information on the nature of the business activities of the parties involved in an investment transaction, information about the status of the review or investigation, and information on any withdrawal from the process, any roll call votes by the committee, any extension of time for any investigation, and any presidential decision or action taken under the Exon-Florio provision. In addition, CFIUS is required to report on trend information on the number of filings, investigations, withdrawals, and presidential decisions or actions that were taken. The report must include cumulative information on the business sectors involved in filings and the countries from which the investments originated; information on the status of the investments of companies that withdrew notices and the types of security arrangements and conditions CFIUS used to mitigate national security concerns; the methods the committee used to determine that firms were complying with mitigation agreements

or conditions; and a detailed discussion of all perceived adverse effects of investment transactions on the national security or critical infrastructure of the United States.

The Secretary of the Treasury, in consultation with the Secretary of State and the Secretary of Commerce, is required to conduct a study on investment in the United States, particularly in critical infrastructure and industries affecting national security by (1) foreign governments, entities controlled by or acting on behalf of a foreign government, or persons of foreign countries which comply with any boycott of Israel; or (2) foreign governments, entities controlled by or acting on behalf of a foreign government, or persons of foreign countries which do not ban organizations designated by the Secretary of State as foreign terrorist organizations. In addition, CFIUS is required to provide an annual evaluation of any credible evidence of a coordinated strategy by one or more countries or companies to acquire U.S. companies involved in research, development, or production of critical technologies in which the United States is a leading producer. The report must include an evaluation of possible industrial espionage activities directed or directly assisted by foreign governments against private U.S. companies aimed at obtaining commercial secrets related to critical technologies.

The Inspector General of the Department of the Treasury is required to investigate any failure of CFIUS to comply with requirements for reporting that were imposed prior to the passage of P.L. 110-49 and to report the findings of this report to Congress. In particular, the report must be sent to the chairman and ranking Member of each committee of the House and the Senate with jurisdiction over any aspect of the report, including the Committee on International Relations, the Committee on Financial Services, and the Committee on Energy and Commerce of the House.

The chief executive officer of any party to a merger, acquisition, or takeover is required to certify in writing that the information contained in the written notification to CFIUS fully complies with the requirements of the Exon-Florio provision and that the information is accurate and complete. This written notification would also include any mitigation agreement or condition that was part of a CFIUS approval.

Caseload

As a consequence of the confidential nature of the CFIUS review of any proposed transaction, there are few public sources of information, other than a congressionally mandated annual report, concerning the committee's work to date. For the most part, information concerning individual transactions that have been reviewed by CFIUS or any final recommendations that have been issued by CFIUS have come from announcements made by the companies involved in a transaction and not by CFIUS. Therefore, public information concerning the outcome of CFIUS's reviews is incomplete. As indicated in **Table 1**, CFIUS has received more than 1,500 notifications, of which it conducted a full investigation of 25 cases. Of these 25 cases, 13 transactions were withdrawn upon notice that CFIUS would conduct a full review and 12 of the remaining transactions cases were sent to the President. Of these 12 transactions, 1 was prohibited.[41]

[41] Auerbach, Stuart. "President Tells China to Sell Seattle Firm." *The Washington Post*, February 3, 1990. p. A1; and Benham, Barbara. "Blocked Takeover Fuels Foreign Policy Flap." *Investor's Daily*, February 8, 1990. p. 1.

The one transaction that was prohibited by the President involved the acquisition in 1990 of Mamco Manufacturing Company by the China National Aero-Technology Import and Export Corporation (CATIC). Mamco was an aerospace parts manufacturer. CATIC, which is owned by the Government of the People's Republic of China, acted as the purchasing agent for the Chinese Ministry of Defense. President Bush ordered CATIC to divest itself of Mamco under the authority of the Exon-Florio provision because of concerns that CATIC might gain access to technology through Mamco that it would otherwise have to obtain under an export license.[42] One recent case that involved a Chinese firm that was reviewed by CFIUS and approved was the proposed acquisition of IBM's Personal Computing Division to Lenovo Group Limited, a Chinese manufacturing company. Apparently, CFIUS has approved any number of proposed transactions if the parties involved agreed to certain conditions.

Table 1. CFIUS Notifications and Investigations, 1988-2005

	Notifications	Investigations	Notices withdrawn	Presidential decision
1988	14	1	0	1
1989	204	5	2	3
1990	295	6	2	4
1991	152	1	0	1
1992	106	2	1	1
1993	82	0	0	0
1994	69	0	0	0
1995	81	0	0	0
1996	55	0	0	0
1997	62	0	0	0
1998	65	2	2	0
1999	79	0	0	0
2000	72	1	0	1
2001	55	1	1	0
2002	43	0	0	0
2003	41	2	1	1
2004	53	2	2	0
2005	65	2	2	0
Total	1,593	25	13	12

Source: Graham, Edward M., and David M. Marchick, *US National Security and Foreign Direct Investment*. p. 57.

[42] Auerbach, Stuart. "President Tells China to Sell Seattle Firm." *The Washington Post*, February 8, 1990, p. A1; and Benham, Barbara. "Blocked Takeover Fuels Foreign Policy Flap." *Investor's Daily*, February 8, 1990. p. 1.

Recent Transactions

According to the annual report filed by CFIUS under the requirements of P.L. 110-49,[43] CFIUS activity dropped sharply in 2009 and 2010 as a result of tight credit markets willing to fund acquisitions and takeovers during the global financial crisis, but rebounded in 2010, as indicated in **Table 2**. During the three-year period 2008-2010, foreign investors sent 313 notices to CFIUS of plans to acquire, take over, or merge with a U.S. firm. Of the investment transactions that were notified, about 10% were withdrawn during the initial 30-day review; about 30% of the total transactions that were notified were determined to require a 45-day investigation. Also, of the transactions that were investigated, about 14% were withdrawn before a final determination could be reached. As a result, of the 313 proposed investment transactions that were notified to CFIUS, 261 transactions, or 83% of the transactions, were completed. The CFIUS report also indicates that a presidential decision was not made in any of the transactions, whether because transactions that might have been recommended by CFIUS to be blocked by the President were withdrawn before CFIUS could make its recommendation, or because CFIUS did not offer a recommendation that a transaction be blocked by the President.

Table 2. Foreign Investment Transactions Reviewed by CFIUS, 2008-2010

Year	Number of Notices	Notices Withdrawn During Review	Number of Investigations	Notices Withdrawn During Investigation	Presidential Decisions
2008	155	18	23	5	0
2009	65	5	25	2	0
2010	93	6	35	6	0
Total	313	29	93	13	0

Source: *Annual Report to Congress*, Committee on Foreign Investment in the United States, December 2011.

The CFIUS report also indicates that three-fourths of the foreign investment transactions that were notified to CFIUS were in the manufacturing and finance, information, and services sectors, as indicated in **Table 3**. Within the manufacturing sector, about half of all the investment transactions notified to CFIUS were in the computer and electronic products sectors. The next two sectors with the highest number of transactions were the transportation equipment sector and the machinery sector. Investment transactions in the services sector accounted for two-thirds of the total number of investment transactions in the finance, information, and services category.

[43] *Annual Report to Congress*, Committee on Foreign Investment in the United States, December 2011.

Table 3. Industry Composition of Foreign Investment Transactions Reviewed by CFIUS, 2008-2010

Year	Manufacturing	Finance, Information, and Services	Mining, Utilities, and Construction	Wholesale and Retail Trade	Total
2008	72	42	25	16	155
2009	21	22	19	3	65
2010	36	35	13	9	93
Total	129	99	57	28	313

Source: *Annual Report to Congress*, Committee on Foreign Investment in the United States, December 2011.

Table 4 shows foreign investment transactions by the home country of the foreign investor and the industry composition of the investment transactions. According to data based on notices provided to CFIUS by foreign investors, British investors were the most active in acquisitions, takeovers, or mergers during the 2008-2010 period, accounting for nearly one-third of the total number of transactions. France and Israel join the United Kingdom as the top three countries of origin for investors providing notifications to CFIUS. In all three countries, investments were concentrated in the manufacturing and finance, information, and services sectors. The ranking of countries in **Table 4** differs in a number of important ways from data published by the Bureau of Economic Analysis on the cumulative amount, or the total book value, of foreign direct investment in the United States, which places the United Kingdom, Japan, Netherlands, Germany, Canada, and Switzerland as the most active countries of origin for foreign investment in the United States.

Table 4. Country of Foreign Investor and Industry Reviewed by CFIUS, 2008-2010

Country	Manufacturing	Finance, Information, and Services	Mining, Utilities, and Construction	Wholesale Trade and Retail Trade	Total
United Kingdom	44	37	8	2	91
France	14	4	4	3	25
Israel	13	9		2	24
Canada	3	9	10	2	24
Japan	4	8	6	1	19
China	8	3	4	1	16
Russian Fed.	6	3	2	1	12
Italy	8	2			10
Netherlands	2	4	1	1	8
Sweden	3	5			8
Total	129	99	57	28	313

Source: *Annual Report to Congress*, Committee on Foreign Investment in the United States, December 2011.

The CFIUS annual report also provides some general information on the total number of cases in which it applied legally binding mitigation measures. The report did not list any specific cases or measures, but it did indicate that CFIUS applied mitigation measures to 16 cases in the 2008-

2010 period. According to CFIUS, in 2010, CFIUS agencies negotiated, and parties adopted, mitigation measures for nine covered transactions.[44] Mitigation measures have included a number of different approaches, including:

- Requiring a subsidiary with sensitive technology or classified contracts have a separate and independent board of directors composed of U.S. citizens.
- Requiring the board of directors to establish a security committee composed of independent directors who are U.S. citizens and have independent authority over security compliance.
- Restricting the type of information that can be provided by the U.S. subsidiary to the foreign parent and the identity/number of parent company employees who are allowed access to the information.
- Restricting access by non-U.S. citizens to critical infrastructure.
- Requiring the screening of employees and contractor personnel with access to critical infrastructure.
- Requiring firms to obtain prior approval of seller contracts for certain goods or services where the seller is foreign-owned.
- Requiring firms adopt and implement network and IT security policy.

CFIUS also has implemented procedures to evaluate and ensure that parties to an investment transaction remain in compliance with any risk mitigation measures that were adopted to gain approval of the investment.

Conclusions

On July 26, 2007, President Bush signed **P.L. 110-49**, the Foreign Investment and National Security Act of 2007. The Treasury Department released its regulations implementing this law on November 21, 2008, as the global financial crisis was the focus of attention. In 2008, tight credit conditions associated with the global financial crisis and the slowdown in the rate of growth in the U.S. economy retarded merger and acquisition activities in the United States and abroad. On June 20, 2011, the Obama Administration issued a formal statement on foreign investment declaring the countries' commitment to an open investment policy.[45]

When Congress adopted P.L. 110-49, the Foreign Investment and National Security Act of 2007, Members were concerned about six issues: (1) the seeming lack of participation by principal members of CFIUS; (2) CFIUS's interpretation of requirements that it investigate transactions involving firms that are owned or controlled by a foreign government; (3) reporting requirements that have not provided Congress with enough information for Members to fulfill their oversight responsibilities; (4) the discretion CFIUS exercises in choosing which transactions it investigates; (5) CFIUS's definition of national security; and (6) CFIUS's deadlines for completing reviews and investigations. All of these issues were addressed to varying degrees in the law, but it likely

[44] *Annual Report to Congress*, Committee on Foreign Investment in the United States, December 2011.

[45] Statement by the President on United States Commitment to Open Investment Policy, the White House, June 20, 2011.

will take some time and experience with the new provisions for Members to determine if the changes to the Exon-Florio process satisfy their concerns.

Since Congress passed P.L. 110-49, concerns among the public and Members of Congress rose sharply for some time about firms that are controlled by foreign governments investing in economic activities that some judge to be detrimental to the nation's homeland security and critical infrastructure. Although P.L. 110-49 broadened the concept of national security to include homeland security and critical infrastructure, it remains unclear how these concepts are being incorporated into the Exon-Florio process and if those who administer the process have altered their views to reflect the broadened concept of national security as it is specified in the statute. At times, Members of Congress and officials within the Administration have been at odds over the way CFIUS has reviewed and approved of certain investments. These differences reflect a disparity in political and philosophical viewpoints over the role of foreign investment in the economy and over the nature of the risks the investments pose to the national economic security. The occasional sparring over foreign investment between Congress and the Administration reflects the fact that neither Congress nor the Administration has been able thus far to define clearly the national security implications of foreign direct investment.

The DP World transaction revealed that the September 11, 2001, terrorist attacks may have fundamentally altered the viewpoint of some Members of Congress regarding the role of foreign investment in the economy and over the impact of such investment on the national security framework. If this assessment is correct, then the change in attitude will require a reassessment of the role of foreign investment in the economy and of the implications of corporate ownership of activities that fall under the rubric of critical infrastructure. In addition, the DP World transaction focused attention on long-unresolved issues concerning the role of foreign investment in the nation's overall security framework and the methods that are being used to assess the impact of foreign investment on the nation's defense industrial base and homeland security.

In 2012, the growing number of investments by Chinese firms sparked concerns by a number of groups over the economic and security impact of the investments, similar to concerns about Japanese investment in the United States in the 1980s. In particular, on October 8, 2012, the House Permanent Select Committee on Intelligence published a report[46] on "the counterintelligence and security threat posed by Chinese telecommunications companies doing business in the United States." The report offered a number of policy recommendations affecting CFIUS, including:

- The Committee on Foreign Investment in the United States (CFIUS) must block acquisitions, takeovers, or mergers involving Huawei and ZTE given the threat to U.S. national security interests. Legislative proposals seeking to expand CFIUS to include purchasing agreements should receive thorough consideration by relevant congressional committees.
- Committees of jurisdiction in the U.S. Congress should consider potential legislation to better address the risk posed by telecommunications companies with nation-state ties or otherwise not clearly trusted to build critical infrastructure. Such legislation could include increasing information sharing

[46] Investigative Report on the U.S. National Security Issues Posed by Chinese Telecommunications Companies Huawei and ZTE: A Report by Chairman Mike Rogers and Ranking Member C.A. Dutch Ruppersberger of the Permanent Select Committee on Intelligence, U.S. House of Representatives, October 8, 2012.

among private sector entities, and an expanded role for the CFIUS process to include purchasing agreements.

In addition, in November 2012, the U.S.-China Economic and Security Review Commission[47] issued a report that detailed concerns over Chinese investments by U.S. industries, lawmakers, and government officials about the "potential economic distortions and national security concerns arising from China's system of state-supported and state-led economic growth." In particular, some observers argued that economic concerns focused on the possibility that state-backed Chinese companies choose to invest "based on strategic rather than market-based considerations," and are free from the constraints of market forces because of generous state subsidies. The report proffered a number of recommendations for amending the CFIUS statute:

- Congress examine foreign direct investment from China to the United States and assess whether there is a need to amend the underlying statute (50 U.S.C. app 2170) for the Committee on Foreign Investment in the United States (CFIUS) to (1) require a mandatory review of all controlling transactions by Chinese state-owned and state-controlled companies investing in the United States; (2) add a net economic benefit test to the existing national security test that CFIUS administers; and (3) prohibit investment in a U.S. industry by a foreign company whose government prohibits foreign investment in that same industry.
- Legislation creating the Committee on Foreign Investment in the United States (CFIUS) could be amended to add a test of "economic benefit" of a Chinese investment in the United States.
- CFIUS's jurisdiction be extended to include "greenfield" investments, or investments in new industrial plants and facilities.

Most economists agree that there is little economic evidence to conclude that foreign ownership, whether by a private entity or by an entity that is owned or controlled by a foreign government, has a measurable impact on the U.S. economy as a whole. Others may argue on non-economic grounds that such firms pose a risk to national security or to homeland security.

Similar issues concerning corporate ownership were raised during the late 1980s and early 1990s when foreign investment in the U.S. economy increased rapidly. There are little new data, however, to alter the conclusion reached at that time that there is no definitive way to assess the economic impact of foreign ownership or of foreign investment on the economy. Although some observers have expressed concerns about foreign investors who are owned or controlled by foreign governments acquiring U.S. firms, there is little confirmed evidence that such a distinction in corporate ownership has any measurable effect on the economy as whole.

For most economists, the distinction between domestic- and foreign-owned firms, whether the foreign firms are privately owned or controlled by a foreign government, is sufficiently small that they would argue that it does not warrant placing restrictions on the inflow of foreign investment. Nevertheless, foreign direct investment does entail various economic costs and benefits. On the benefit side, such investments bring added capital into the economy and potentially could add to productivity growth and innovation. Such investment also represents one repercussion of the U.S. trade deficit. The deficit transfers dollar-denominated assets to foreign investors, who then decide

[47] 2012 Report to Congress of the U.S.-China Economic and Security Review Commission, U.S. China Economic and Security Review Commission, November 2012.

how to hold those assets by choosing among various investment vehicles, including direct investment. Foreign investment also removes a stream of monetary benefits from the economy in the form of repatriated capital and profits that reduces the total amount of capital in the economy. Such costs and benefits likely occur whether the foreign owner is a private entity or a foreign government.

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