Foreign Investment, CFIUS, and Homeland Security: An Overview

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March 29, 2013

Congressional Research Service
7-....
www.crs.gov
RS22863

CRS Report for Congress
Prepared for Members and Committees of Congress

Summary

The President is generally seen as exercising broad discretionary authority over developing and implementing U.S. direct investment policy, including the authority to suspend or block investments that "threaten to impair the national security." Congress is also directly involved in formulating the scope and direction of U.S. foreign investment policy. At times, some Members have urged the President to be more aggressive in blocking certain types of foreign investments. Such confrontations reflect vastly different philosophical and political views between Members of Congress and between Congress and the Administration over the role foreign investment plays in the economy and the role that economic activities should play in the context of U.S. national security policy. In July 2007, Congress asserted its own role in making and conducting foreign investment policy when it adopted and the President signed P.L. 110-49, the Foreign Investment and National Security Act of 2007. This law broadens Congress's oversight role, and it explicitly includes the areas of homeland security and critical infrastructure as separately identifiable components of national security that the President must consider when evaluating the national security implications of a foreign investment transaction. At times, the act has drawn Congress into a greater dialogue over the role of foreign investment in the economy, and conflicts with the Administration over efforts to define the limits of the broad rubric of national economic security.

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Foreign Direct Investment in the United States

The United States is the largest foreign direct investor in the world and also the largest recipient of foreign direct investment. By year-end 2011, foreign direct investment in the United States had reached $2.6 trillion and U.S. direct investment abroad had reached $4.1 trillion. This dual role means that globalization, or the spread of economic activity by firms across national borders, has become a prominent feature of the U.S. economy and that through direct investment the U.S. economy has become highly enmeshed with the broader global economy.

The globalization of the economy also means that the United States has important economic, political, and social interests at stake in the development of international policies regarding direct investment. With some exceptions for national security,[1] the United States has established domestic policies that treat foreign investors no less favorably than U.S. firms. In addition, the United States has led efforts over the past 50 years to negotiate internationally for reduced restrictions on foreign direct investment, for greater controls over incentives offered to foreign investors, and for equal treatment under law of foreign and domestic investors. In light of the terrorist attacks on the United States on September 11, 2001, however, some Members have questioned this open-door policy and have argued for greater consideration of the long-term impact of foreign direct investment on the structure and the industrial capacity of the economy, and on the ability of the economy to meet the needs of U.S. defense and security interests.

Committee on Foreign Investment in the United States (CFIUS)

Arguably the most important, and most controversial, activities related to foreign direct investment are the reviews and investigation of foreign investments in the United States by the Committee on Foreign Investment in the United States (CFIUS).[2] The Committee is an interagency organization that serves the President in overseeing the national security implications of foreign investment in the economy. Originally established by an Executive Order of President Ford in 1975, the committee has operated until recently in relative obscurity.[3] CFIUS has "the primary continuing responsibility within the Executive Branch for monitoring the impact of foreign investment in the United States, both direct and portfolio, and for coordinating the implementation of United States policy on such investment."[4] Following its creation by Executive Order, the Committee met infrequently and played a low-profile role in monitoring foreign investment in the economy until 1988, when Congress approved the Exon-Florio provision.[5]

[1] CRS Report RL33103, *Foreign Investment in the United States: Major Federal Statutory Restrictions*, by (name redac ted).

[2] For additional information, see CRS Report RL33388, *The Committee on Foreign Investment in the United States (CFIUS)*, by (name redacted).

[3] Executive Order 11858 (b), May 7, 1975, 40 F.R. 20263.

[4] Ibid.

[5] P.L. 100-418, Title V, Section 5021, August 23, 1988; 50 USC Appendix sect. 2170. For additional information, CRS Report RL33312, *The Exon-Florio National Security Test for Foreign Investment*, by (name redacted).

The Exon-Florio provision grants the President broad discretionary authority to take what action he considers to be "appropriate" to suspend or prohibit proposed or pending foreign acquisitions, mergers, or takeovers which "threaten to impair the national security." Congress directed that before this authority can be invoked the President must conclude that (1) other U.S. laws are inadequate or inappropriate to protect the national security; and (2) that he must have "credible evidence" that the foreign investment will impair the national security. As a result, if CFIUS determines that it does not have credible evidence that an investment will impair the national security 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.

In the Exon-Florio provision (and the subsequent P.L. 110-49), national security was not defined, but was meant to be interpreted broadly. Nevertheless, regulations developed by the Treasury Department to implement the law direct the members of CFIUS to focus their reviews of foreign investments exclusively on those transactions that involve "products or key technologies essential to the U.S. defense industrial base," and not to consider economic concerns more broadly. CFIUS also 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."[6]

When Congress adopted the Exon-Florio provision, many Members were concerned that the United States could not prevent foreign takeovers of U.S. firms 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 open and receptive environment for foreign investment.

While CFIUS's activities often seem to be quite opaque, the Committee is not free to establish an independent approach to reviewing foreign investment transactions, but operates under the authority of the President and reflects his attitudes and policies. As a result, any 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.[7] 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.

[6] Ibid.

[7] CRS Report RL33103, *Foreign Investment in the United States: Major Federal Statutory Restrictions*, by (name redac ted).

The Exon-Florio process is comprised of three different steps for reviewing proposed or pending foreign "mergers, acquisitions, or takeovers" of "persons engaged in interstate commerce in the United States" to determine if the transaction "threatens to impair the national security." CFIUS has 30 days to conduct a review, 45 days to conduct an investigation, and then the President has 15 days to make his determination. The President is the only officer with the authority to suspend or prohibit mergers, acquisitions, and takeovers.

Neither Congress nor the Administration has 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.[8] For instance, over time and through a series of Executive Orders, the Department of Defense has developed the National Industrial Security Program (NISP) through which it has adopted various provisions under the term, "Foreign Ownership, Control, or Influence (FOCI)." These provisions attempt to prevent foreign firms from gaining unauthorized access to "critical technology, classified information, and special classes of classified information" through an acquisition of U.S. firms that it could not gain access to through an export control license. This type of review is run independently of and parallel to a CFIUS review.

In 2007, Congress changed the way foreign direct investments are reviewed through P.L. 110-49, the Foreign Investment and National security Act of 2007.[9] Through P.L. 110-49, Congress strengthened its role in two fundamental ways. First, Congress enhanced its oversight capabilities by requiring greater reporting to Congress by CFIUS on the Committee's actions either during or after it completes reviews and investigations and by increasing reporting requirements on CFIUS. Second, Congress fundamentally altered the meaning of national security in the Exon-Florio provision by including critical infrastructure and homeland security as areas of concern comparable to national security. The law also requires the Director of National Intelligence to conduct reviews of any investment that poses a threat to the national security. The law provides for additional factors the President and CFIUS are required to use in assessing foreign investments, including the implications for the nation's critical infrastructure.

In another change, P.L. 110-49 requires CFIUS to investigate all foreign investment transactions in which the foreign entity is owned or controlled by a foreign government, regardless of the nature of the business. Some foreign investors have regarded this approach as a change in policy by the United States toward foreign investment. Prior to this change, foreign investment transactions were reviewed in a way that presumed that the transactions contributed positively to the economy. Consequently, the burden of proof was on the members of CFIUS to prove during a review that a particular transaction threatened to impair national security. P.L. 110-49, however, shifted the burden onto firms that are owned or controlled by a foreign government to prove that they are not a threat to national security. In any given year, the number of investment transactions in which the foreign investor is associated with a foreign government likely is small compared with the total number of foreign investment transactions. The number of such transactions,

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

[9] P.L. 110-49 originated in the first session of the 110th Congress as S. 1610, the Foreign Investment and National Security Act of 2007, introduced by Senator Dodd on June 13, 2007. On June 29, 2007, the Senate adopted S. 1610 in lieu of a competing House version, 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. On January 23, 2008, President Bush issued Executive Order 13456 implementing the law.

however, has grown as some foreign governments experienced a surge in their foreign exchange reserves and they established sovereign wealth funds and invested their reserve funds abroad in an array of activities, including in U.S. businesses.

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[10] on the "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 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[11] 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.

[10] 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.

[11] 2012 Report to Congress of the U.S.-China Economic and Security Review Commission, U.S. China Economic and Security Review Commission, November 2012.

- 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.

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[12] 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.[13] Ralls argued that the President was authorized only to "suspend of 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 by the CFIUS statute, nevertheless, the court indicated that its ruling allowed Ralls' due process claim to proceed. The Ralls' due process claim apparently focused on whether the President and/or CFIUS should be required to 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' analysis for any particular transaction is based on classified information generally not available to the public. Ralls has appealed the case.

In addition, 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

[12] 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.

[13] 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.

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.

Homeland Security

Arguably, the terrorist attacks of September 11, 2001, and a dissatisfaction among some Members over a perceived lack of responsiveness by the administration reshaped Congressional attitudes toward the Exon-Florio provision. This changed perception became apparent in 2006 as a result of the public disclosure that Dubai Ports World[14] was attempting to purchase the British-owned P&O Ports,[15] with operations in various U.S. ports. After the September 11 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).[16] In this act, Congress provided for special support for "critical infrastructure," 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.[17]

This broad definition is enhanced to some degree by other provisions of the act, which specifically identify sectors of the economy that Congress considered as elements in the critical infrastructure of the nation. These sectors include telecommunications, energy, financial services, water, transportation sectors,[18] 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."[19] The following year, Congress transferred the responsibility for identifying critical infrastructure to the Department of Homeland Security (DHS) through the Homeland Security Act of 2002.[20] In addition, the Homeland Security Act added key resources to the list of critical infrastructure (CI/KR) and defined those resources as: "publicly or privately controlled resources essential to the minimal operations of the economy and government."[21] Through a series of Directives, the Department of Homeland Security identified 17 sectors[22] of

[14] 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 Carribean, and North America.

[15] 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.

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

[17] Ibid.

[18] 42 U.S.C. Section 5195c(b)(2).

[19] 42 U.S.C. Section 5195c(b)(3).

[20] P.L. 107-296, Section 2, November 25, 2002; 6 USC, Section 101.

[21] 6 USC, Sec 101(9).

[22] The sectors include (1) Agriculture and Food; (2) Defense Industrial Base; (3) Energy; (4) Public Health and Healthcare; (5) National Monuments and Icons; (6) Banking and Finance; (7) Drinking Water and Water Treatment (continued...)

the economy as falling within the definition of critical infrastructure/key resources and assigned primary responsibility for those sectors to various Federal departments and agencies, which are designated as Sector-Specific Agencies (SSAs).[23] On March 3, 2008, Homeland Security Secretary Chertoff signed an internal DHS memo designating Critical Manufacturing as the 18th sector on the CI/KR list.

Conclusions

The broad sweep of industrial sectors in the economy that fall within the terms "critical infrastructure," "homeland security," and "key resources" reflects a fundamental change in the way some in Congress view national economic security. From this viewpoint, 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, has not been shared by some policymakers, who argue 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. As a result, Congress and the Bush Administration sparred at times over transactions that CFIUS had approved over the objections of various Members of Congress. This clash of views essentially revolved around three long-standing issues: a) what constitutes foreign control of a U.S. firm?; b) how should national security be defined?; and c) which types of economic activities should be targeted for a CFIUS review?

Some Members also perceive greater risks to the economy arising from foreign investments by firms that are 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, 2001, 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 seemed to be out of touch with the post-September 11, 2001, view of national security, because it remained founded in the late 1980s orientation of the Exon-Florio provision, which viewed national security primarily in terms of national defense and downplayed or even excluded a broader notion of economic national security.

These and other concerns about foreign investment underscore the significant differences that remained between Congress and the Bush Administration over the operations of CFIUS and over the economic and security objectives the Committee should be pursuing. 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. On June 20, 2011, the Obama Administration issued a formal statement on foreign investment declaring the countries' commitment to an open investment policy.[24] The proposed

(...continued)

Systems; (8) Chemical; (9) Commercial Facilities; (10) Dams; (11) Emergency Services; (12) Commercial Nuclear Reactors, Materials, and Waste; (13) Information Technology; (14) Telecommunications; (15) Postal and Shipping; (16) Transportation Systems; (17) Government Facilities.

[23] Sector-Specific Agencies include the Departments of: Agriculture, Defense, Energy, Health and Human Services, Homeland Security, Interior, Treasury, and the Environmental Protection Agency.

[24] Statement by the President on United States Commitment to Open Investment Policy, the White House, June 20, (continued...)

acquisition of P&O by Dubai Ports World sparked a broader set of concerns and a wide-ranging discussion between Congress and the Administration over a working set of parameters that establishes a functional definition of the national economic security implications of foreign direct investment. In part, this issue reflects differing assessments of the economic impact of foreign investment on the U.S. economy and differing political and philosophical convictions among Members and between the Congress and various administrations.

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2011.