

Reform of The CFIUS Process In The Wake Of Dubai Ports World

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On July 26, 2007, President Bush signed the "Foreign Investment and National Security Act of 2007" ("FINSA"), which amends Section 721 of the Defense Production Act of 1950 ("Exon-Florio").¹ Although for the most part the Act codifies existing practices, it does have important implications for foreign investors in U.S. persons, including an increased likelihood of 45-day investigations, greater congressional scrutiny, and codification of "evergreen provisions."

BACKGROUND

Exon-Florio authorizes the President to investigate the impact on U.S. national security of mergers, acquisitions, and takeovers by foreign persons of entities engaged in U.S. interstate commerce. The President can suspend or prohibit a transaction, or in the case of a completed transaction, order divestiture, if he concludes that:

- (i) There is credible evidence that the foreign interest exercising control might take action that threatens national security; and
- (ii) The provisions of law, other than the International Emergency Economic Powers Act, do not provide adequate and appropriate authority to protect the national security.

The President delegated his investigative authority under Exon-Florio to the Committee on Foreign Investment in the United States ("CFIUS"), an interagency committee, chaired by the Secretary of Treasury that was first established by executive order in 1975. In addition to Treasury, the Committee has representatives from, among other agencies, the State, Defense, Homeland Security and Commerce Departments. CFIUS interprets its mandate as allowing it to investigate transactions for national security concerns and to negotiate measures that mitigate these concerns.

Filing a transaction for CFIUS review is voluntary, although any member of CFIUS can self-notify a transaction to the Committee. Once notification is made, CFIUS has 30 days to complete its initial review of the transaction. If CFIUS determines after 30 days that there are no issues of national security warranting a further investigation, it closes its review and the transaction is cleared. However, if CFIUS determines during the 30-day review that a transaction may indeed present national security concerns it commences a 45-day investigation to decide whether the issues require further mitigation efforts or a recommendation for Presidential action. At the conclusion of the 45-

¹ The Act goes into effect on October 24, 2007. Regulations interpreting the Act are expected to be promulgated by April 21, 2008.

day investigation, a report is sent to the President who then has 15 days to determine whether the proposed transaction threatens to impair national security and, if so, what the appropriate response should be.

Historically, there have been very few 45-day investigations, in large part because the executive branch – acting through CFIUS – has generally sought to promote foreign investment and free access to markets. Also, historically, the willingness of parties to engage CFIUS proactively on the substance of the transaction, even prior to voluntary notification, has generally offset the need for further investigations beyond the initial review.

Recently, however, CFIUS and the CFIUS review process have come under increasing congressional and public scrutiny.² Matters came to a head in the wake of the Dubai Ports World-Peninsular & Oriental Steam Navigation Company transaction, a transaction that resulted in a steady and at times infuriated congressional push for reform. The result of this congressional initiative is FINSA, which creates a more rigorous and potentially burdensome review process, although one less onerous than some of the original proposals for legislative reform introduced in the aftermath of the DP World transaction.

THE FOREIGN INVESTMENT AND NATIONAL SECURITY ACT OF 2007

FINSA codifies both CFIUS and many of CFIUS' essential features and practices, such as the voluntary nature of notification, the review and investigation timeline, and the negotiation of mitigation agreements. FINSA also adds the Secretary of Energy as a voting member to CFIUS, as well as designates the Secretary of Labor and the Director of National Intelligence as *ex officio*, non-voting members of the Committee.

In addition to the above, the statute features several significant amendments to the current process which are briefly summarized below:

- Designation of Lead Agency: FINSA requires Treasury, while maintaining its gatekeeper and liaison functions, to designate, as appropriate, a CFIUS member agency to take lead on behalf of the Committee in connection with a proposed transaction. This formalizes current Committee practice whereby the CFIUS agency most interested or affected by a transaction often takes lead on discussions with the parties and negotiation of mitigation measures.

² There has been an increase in the number of 45-day investigations over the past two years.

- Expansion of the Concept of National Security: FINSA formally expands the definition of what is considered "national security" so as to include transactions involving critical infrastructure, energy assets and critical technologies.³
- Presumption of a 45-day Investigation For Certain Transactions: Pursuant to FINSA, CFIUS must investigate when (1) the acquirer is controlled by or acting on behalf of a foreign government or (2) the transaction could result in the control of any "critical infrastructure" by a foreign business unless the Secretary of the Treasury and the head of the lead agency jointly determine that the transaction will not impair the national security of the United States, thereby creating a presumption of a 45-day investigation and in the view of some commentators, shifting the burden of proof on the issue of the impact on national security to the parties to the proposed transaction.
- Increased Congressional Oversight: FINSA requires CFIUS to provide written notice to Congress at the completion of a 30-day review or 45-day investigation. In addition, CFIUS is required to provide an annual report to Congress on its activities.
- Changes to Mitigation Measures: FINSA now establishes statutory authority for mitigation measures. Compliance with mitigation measures is to be monitored by the lead agency. In addition, that agency must provide "periodic" reports concerning modifications to those mitigation measures.
- Evergreen Provision: FINSA allows CFIUS to "reopen" a previously reviewed transaction if a party to the transaction materially breaches a mitigation measure. If a party materially breaches a mitigation measure, the review will be reopened only if, in addition to the initial breach, (1) the lead agency finds the breach intentional, and (2) all CFIUS members find that no other remedies are available to deal with the breach.

CONCLUSION

As a general matter, FINSA codifies pre-existing CFIUS practices and brings greater transparency and predictability to the CFIUS-review process. However, FINSA also amends the CFIUS process so that it is now more likely that transactions, particularly those involving foreign state actors or entities controlled by foreign state actors, will be subject to more extensive 45-day investigations and the "evergreen provisions" add an extra layer of risk for the foreign investor in a covered transaction. Accordingly, it is more important than ever that parties to a transaction along with their counsel identify early on whether the transaction is likely to implicate Exon-Florio, and if so, adopt a proactive approach to the CFIUS review process.

³ In practical terms, this provision codifies existing CFIUS practice because the Committee, in an exercise of its considerable discretion, normally takes into account the impact of a proposed transaction on these areas.

SIMPSON
THACHER

The Firm's Washington, D.C. office regularly counsels clients in connection with the CFIUS-review process. For further information about CFIUS and the FINSA reforms, please feel free to contact:

Peter C. Thomas (202-220-7735 pthomas@stblaw.com)

Brijesh P. Dave (202-220-7739 bdave@stblaw.com)