



Commentary

Tightening The Screws On Foreign Investment

Harry L. Clark 10.23.07, 6:00 AM ET

WASHINGTON - As of Wednesday, a new law will formalize modified U.S. government approaches to screening deals for their national security impact when foreign companies acquire or merge with American companies. While the business community avoided a variety of extreme proposals, the "Foreign Investment and National Security Act," known as FINSA, provides that broad categories of foreign direct investment must now survive new levels of scrutiny by federal agencies, more active participation by Congress, and possibilities for political roadblocks raised by competitors.

The president has been authorized to screen foreign direct investment for national security concerns since the Exon-Florio Amendment was passed in 1988. Screening is undertaken by the Committee on Foreign Investment in the United States (CFIUS), comprised of major executive agencies such as the Departments of Defense, State, Treasury (the lead agency) and now Homeland Security. For the first several years, though, serious screening was generally confined to foreign acquisitions of defense contractors.

The committee's conception of national security and approach to screening began to expand as concerns about international terrorism intensified in the 1990s. By the late 1990s, a series of its examinations of civil telecommunications companies signaled a shift by the U.S. government toward viewing foreign control of major U.S. infrastructure as a national security issue. The 2001 terrorist attacks accelerated the trend toward a broader conception of national security risk from foreign investment.

The watershed was Dubai Ports World's 2006 acquisition of a company with contracts to operate several U.S. ports. The Bush administration cleared the transaction under Exon-Florio rules. But an outcry in Congress and the media, fueled by a U.S. port operator's lobbying, resulted in the Dubai Ports' decision to sell the U.S. port operations notwithstanding clearance by the CFIUS. Along with the Chinese oil company **CNOOC's** failed 2005 attempt to acquire Unocal, the Dubai Ports World transaction led the Bush Administration to intensify and formalize CFIUS screening. By and large, the new Foreign Investment and National Security Act simply ensures that the government cannot backtrack on reforms instituted by the Bush administration.

Basic attributes of the CFIUS screening remain unchanged under the FINSA. The committee can examine any transaction that results in foreign control over a U.S. business. (Many have complained about Bain Capital's plan to buy 3Com, but it is not clear that the minority position of Huawei, the Chinese investor, would give it the control needed for committee screening.) Parties to a transaction can, but are not obligated to, notify the committee of a transaction to initiate screening. If they do not notify a transaction and there is no committee clearance, though, the President is free to order divestment at any time into the future.

Screening modifications should enhance the predictability and transparency of the CFIUS screening process. But they also introduce challenges and uncertainties for any company involved in such a transaction.

First, deals formerly not considered to have national security implications--such as those involving an oil refinery or toll road--now attract examination (sometimes at the government's insistence). The CFIUS is to scrutinize acquisitions by foreign government controlled companies particularly closely. This requirement tends to encompass, for example, acquisitions by Chinese companies and international petroleum companies.

Second, the committee is increasingly making clearance contingent on changes to transactions, such as spin-offs of sensitive divisions, and contract commitments by the parties to, among other things, regularly update the government on issues of concern. The foreign investment act establishes that the government can penalize parties for violations of these commitments and, in some circumstances, reopen screening even if the transaction has been cleared.

Third, government agencies have developed substantial bureaucracies devoted to foreign investment screening. And they have begun to use the committee's screening as an opportunity to investigate legal and other issues associated with a foreign buyer. Some agency officials, congressional offices and commercial competitors will highlight, for example, that the acquirer operates in countries like Iran that are subject to U.S. embargoes.

Fourth, greater visibility of the committee's screening and requirements that the committee report to Congress on screening cases will intensify the ability of congressional offices and competitors to leverage screening to try to disrupt transactions.

One might reasonably question the likelihood that foreign ownership, in and of itself, would establish vulnerabilities to terrorism. Notably, Congress was emphatic in 1988 that the Exon-Florio law would merely provide the president with the authority to act in highly unusual cases, and that it would not lead to a system of broadly, systematically critiquing inbound investment. Regulations that the CFIUS is developing to implement the foreign investment act should establish limits on, for instance, the committee's discretion to restart examinations of transactions that have been cleared and federal agencies' latitude to hold up clearances to address irrelevant legal issues associated with acquirers.

Regardless, though, the changes leading up to and required by the FINSA are creating just what Congress sought to avoid--an effectively mandatory process of government review of foreign direct investment that might even arguably have national security implications.

This screening entails legal, policy, political and media dimensions and can significantly delay, complicate and, potentially, prevent transactions. Companies are well served by developing a plan effectively to address all of these dimensions during early stages of a foreign acquisition of or international merger involving a U.S. business.

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