

National Security Foreign Investment Reform and Strengthened Transparency Act of 2007

INTRODUCTION AND BACKGROUND

On February 28, 2007, the U.S. House of Representatives passed H.R. 556 to reform the laws authorizing the Committee on Foreign Investment in the United States (“CFIUS”) to review certain transactions whereby a foreign person or entity acquires control of a U.S. business. H.R. 556 is titled the “National Security Foreign Investment Reform and Strengthened Transparency Act of 2007” [“CFIUS Reform Act”].

The CFIUS Reform Act has not yet become law. As a bill adopted solely by the U.S. House of Representatives, the CFIUS Reform Act will not become law unless, and until, it is adopted by the U.S. Senate and signed by the President. Should the U.S. Senate adopt a similar but not identical bill, the U.S. House of Representatives and the U.S. Senate would designate Members to participate in a conference committee to resolve the differences between the bills. Any bill produced by the conference committee would need to be approved by the U.S. House of Representatives and the U.S. Senate, and signed by the President, before it would become law.

As background, the current CFIUS process covers transactions whereby a foreign party obtains control of a U.S. business. The filing of a formal CFIUS notification triggers a review period which cannot last more than 90 days. The initial review is limited to 30 days, after which the transaction is cleared or CFIUS proceeds to an investigation. Any investigation must be completed within 45 days, and the President has 15 days in

which to take action. CFIUS clearance is final and cannot be re-opened. Several agencies, which are CFIUS Members, have negotiated contracts, known as National Security Agreements, with foreign parties in certain cases where such parties have obtained control of a U.S. telecommunications business. CFIUS review often proceeds on a parallel track with other federal agency proceedings, such as licensing matters with the Federal Communications Commission. Although CFIUS filings are formally “voluntary” in most cases, many parties decide to make such a filing to remove the possibility that the U.S. government could later conduct a CFIUS review and seek to undo the acquisition or merger.

In general, the CFIUS Reform Act would institute several important changes to the current CFIUS process and would potentially make it more onerous for foreign entities to acquire U.S. businesses in the telecommunications industry and in other industries that are considered to implicate critical infrastructure in the U.S.

THE CFIUS REFORM ACT

The most significant proposed changes are the following:

- CFIUS approval would no longer be final. The CFIUS Reform Act states that CFIUS may re-open a previously approved transaction if CFIUS believes that one of the parties submitted “false or misleading material information” or “omitted material information” during the initial CFIUS review.

- Similarly, the bill would authorize CFIUS to re-open a previously approved transaction if one of the parties commits an intentional and material breach of a National Security Agreement in cases where there is no other “remedy or enforcement tool available to address such breach.”
- The CFIUS Reform Act would permit CFIUS for the first time to extend an investigation beyond the 45-day period should the President or two-thirds of the CFIUS members request such an extension. The maximum extension period would be an additional 45 days.
- For the first time, the CFIUS Reform Act would give CFIUS the authority to conduct hearings, compel testimony, receive evidence, and administer oaths. The bill would give the functional equivalent of subpoena power to CFIUS to require witnesses to attend hearings and to require the production of any materials CFIUS deems “advisable.”
- The bill provides that a CFIUS review of a transaction that is deemed to threaten to impair U.S. national security must proceed to a full investigation if any CFIUS member desires such an investigation.
- The bill provides that, while not a formal CFIUS member, the Director of National Intelligence shall “expeditiously” provide a “thorough analysis” to CFIUS as to the national security risk posed by each covered transaction, and the Director shall have access to information from the Director of the Office of Foreign Assets Control (OFAC) in the Treasury Department and the Director of the Financial Crimes Enforcement Network.
- The CFIUS Reform Act requires CFIUS to conduct a full investigation should the Director of National Intelligence determine that a transaction raises “particularly complex intelligence concerns” and CFIUS members are not able to develop measures to satisfactorily mitigate such concerns.

In addition, the CFIUS Reform Act would institute other changes:

- With regard to a transaction whereby an entity owned or controlled by a foreign government (or an entity acting on behalf of a foreign government) seeks to acquire a U.S. business, the CFIUS Reform Act clarifies that the transaction shall not be cleared during the initial 30-day review period, but instead shall proceed to the 45-day investigation. An exception to this rule is when the Secretaries of the Treasury, Homeland Security, and Commerce determine that the transaction will not affect U.S. national security even in the absence of a National Security Agreement.
- The bill provides that neither the 30-day CFIUS review nor the 45-day CFIUS investigation shall be considered complete without (i) the approval of a majority of the members of CFIUS in a roll call vote; and (ii) the signatures of the Treasury, Homeland Security, and Commerce Secretaries (subject to limited delegation rights). In the case of a transaction involving a foreign government controlled entity, the 45-day investigation shall not be complete, absent unanimous CFIUS approval, unless the President of the United States signs the investigation findings and report.
- Under the bill, the Treasury Secretary would remain as Chairperson of CFIUS, while the Homeland Security

and Commerce Secretaries would be added as Vice Chairpersons.

- The bill would clarify that the term “national security” applies to all issues relating to homeland security, including its application to “critical infrastructure.” The term “critical infrastructure” is not defined.
- The bill requires CFIUS to designate a lead agency (or agencies) to negotiate and enforce National Security Agreements with covered parties in order to “mitigate” national security risks based on a “risk-based” threat analysis. The lead agency (or agencies) is required to submit periodic reports to CFIUS regarding such agreements.
- The CFIUS Reform Act requires CFIUS to submit transaction-specific and annual written reports to Congress, subject to confidentiality protections, and to provide a classified briefing in response to a written request by an appropriate Member of Congress.
- Parties submitting a notification to CFIUS must submit a certification by the CEO or designee that the notification fully complies with CFIUS requirements and is accurate and complete in all material respects.

CONSEQUENCES OF ADOPTION

If adopted by Congress, the CFIUS Reform Act would implement a significant change in the current CFIUS rules and procedures. Of course, many of the bill’s provisions would simply codify what we understand to be CFIUS’s current practices. While these provisions would not necessarily embody a substantive change in the current CFIUS regime, codifying these practices

could result in making CFIUS more rigid and less flexible than it is today.

Further, the key changes to the CFIUS process noted above represent a potentially significant change to the CFIUS rules and procedures. The impact would be particularly noticeable in the global telecommunications industry. It is clear, based on current practice, that CFIUS regards the U.S. telecommunications sector as embodying critical infrastructure, and a number of foreign entities have been required to sign National Security Agreements as a precondition to receiving CFIUS clearance and/or necessary licenses from the Federal Communications Commission over the past ten years. The CFIUS Reform Act could transform the CFIUS process into a higher entry barrier for foreign entities desiring to enter the U.S. telecommunications market through acquisition or merger. Moreover, if applied to certain pre-existing National Security Agreements (which is not expressly addressed in the bill), the CFIUS Reform Act would change the risk profile faced by foreign entities who already have entered the U.S. telecommunications market in reliance on the previous CFIUS regime.

In general, this bill likely would result in longer, and more expensive, CFIUS investigations. The overarching benefit of the current CFIUS regime – receipt of final clearance to proceed with a transaction – would be undermined by provisions permitting CFIUS to re-open previously closed inquiries. Another benefit of the current regime – a final determination within 90 days – is undermined by the 45-day extension option. The CFIUS process itself could become more adversarial, and costly, in light of the bill’s provisions authorizing evidentiary and enforcement proceedings.

This bill's new CFIUS procedures and protocols would create numerous obstacles to obtaining clearance from CFIUS for any transaction, particularly one involving an entity owned by or operated on behalf of a foreign governmental entity.

Ironically, the bill likely would appear to make the CFIUS process more cumbersome and subject to influence from a variety of disparate sources. Any party who opposes a particular transaction, for whatever reason, will now have more political levers to pull in an effort to deny or delay CFIUS approval, and to make it more expensive and burdensome for the filing parties.

This bill also could have the unintended effect of deterring parties from making a CFIUS filing before contemplating a transaction. CFIUS filings remain "voluntary," and by diluting the benefits of the CFIUS regime, this bill might result in more parties taking their chances with concluding a transaction without invoking the CFIUS process. Of course, the most detrimental potential effect would be to chill the willingness of foreign investors to seek to enter the U.S. telecommunications market through acquisition or merger.

FOR MORE INFORMATION

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