Northwestern Journal of International Law & Business

Volume 9
Issue 3 *Winter*

Winter 1989

Regulation of Foreign Direct Investment in the United States Defense Industry

Mark L. Hanson

The Regulation of Foreign Direct Investment in the United States Defense Industry

I. Introduction

From 1973 to 1986, the amount of foreign capital invested in the United States increased tenfold.[1] In 1973, the amount of foreign direct investment in the United States was $20.556 billion. By 1986, that figure had increased to $209.329 billion. Clearly, foreign capital has become a necessary element for the economic growth of the United States and has contributed significantly to the development of the nation.

Private investment falls into two categories: "direct" and "portfolio." Foreign direct investment is the amount that residents of a country invest in a foreign establishment or enterprise and thereby acquire partial or total control of the firm or enterprise.[2] Generally, the goal of a direct investor is to gain an effective voice in managing the firm, sharing the profits, and directing the operations of the particular business in the host country. Portfolio investment occurs when foreign investors seek to diversify their assets by purchasing securities in a corporation but do not hold enough shares to manage or control the business.[3] Foreign direct investment provides foreign interests with the opportunity to gain control of United States businesses and has become the source of recent concern to United States policymakers.

While capital investment from any source is necessary for the development of individual corporations as well as for the overall expansion of the United States economy, United States policymakers also recognize the danger of unrestricted foreign investment in the United States. Overdependence upon foreign capital could lead to foreign control of ma-

---

1 *See* Scholl, *The International Investment Position of the United States in 1986*, 67 Surv. of Current Bus. 38 (June 1987).

2 The International Investment Survey Act of 1976, 22 U.S.C. § 3101-3108 (1982) defines "direct investment" as the ownership or control, directly or indirectly, by one person of 10% or more of the voting securities of a corporation or the equivalent interest of a non-incorporated enterprise, and includes ownership of any type of property, including real estate.

3 House Comm. on Government Operations, The Adequacy of the Federal Response to Foreign Investment In the United States, H.R. Rep. No. 1216, 96th Cong., 2d Sess. 1 (1980).

jor corporations or entire industries. Such a result could subject United States businesses to the political whims of foreign interests.[4]

Policymakers have periodically raised concerns pertaining to foreign investment in industries which affect national security or an essential national interest. The result has been the development of a small body of regulations which limit or prohibit foreign investment in certain areas of the United States economy. This series of administrative and legislative restrictions was adopted on an ad hoc basis where the need for domestic ownership outweighs the benefits of open investment.

Foreign control can be particularly dangerous in the defense industry, where defense contractors have access to sensitive military information and technology. In 1987, the Reagan administration extensively addressed these dangers when Japanese-based Fujitsu Ltd. announced its intention to acquire Fairchild Semiconductor Corporation, a California-based defense contractor.[5] Although no specific legislative authority restricts foreign investment in the defense industry, the assortment of existing regulations and guidelines provides a sufficient basis for the United States government to eliminate or isolate any dangers such foreign investment may present.

This Comment examines the adequacy of the existing restrictions upon foreign investment in industries holding defense contracts or having access to national security information. After first presenting the reasons underlying the United States commitment to an open investment policy, the existing framework of regulations which apply to investors in any area of the United States economy will be reviewed. An examination of the regulations specifically applicable to investors in the defense industry will follow. Next, the actual operation of the regulatory framework during Fujitsu's attempt to acquire Fairchild Semiconductor Corporation will be considered. Finally, this Comment will analyze the most recent legislative actions to limit foreign investment on a national security basis and will conclude that in implementing the recently enacted Exon Amendment, the United States government must act with restraint and apply its authority to limit only those investments which threaten national security without permitting that authority to become a tool to protect domestic businesses and industries from foreign competition.

II. THE DEVELOPMENT OF AN OPEN INVESTMENT POLICY.

Capital investment from foreign nations played an important role in

---

4 A. ROTH, A GUIDE TO FOREIGN INVESTMENT UNDER UNITED STATES LAW 8 (1979)[hereinafter GUIDE TO FOREIGN INVESTMENT].

5 *See infra* text accompanying notes 64-94.

the growth of the United States, helping to finance the Louisiana Purchase in 1803, the development of a nation-wide railroad network in the 1850s, and the rapid industrialization of the United States during the second half of the Nineteenth Century.[6] Recognizing the importance of an unrestricted flow of capital, United States policy on international investment is founded upon the theory that the private market is "the most efficient means to determine the allocation and use of capital in the international economy."[7] As a result, the United States pursues an "open door" approach to investment which offers no special incentives to foreigners who invest in the United States, and in general, imposes no special barriers. Furthermore, once foreign investors establish themselves within the United States economy, they generally receive the same treatment as domestic investors.

Foreign entities find the United States a favorable investment market for several reasons. First, the United States has one of the most stable economic and political systems in the world, and it subjects businesses to fewer government economic and regulatory controls than do other industrial nations. Second, the United States has the largest consumer market in the world. With its common language and integrated transportation and communication systems, businesses have significant opportunity for future growth and profits. Third, through participation in the United States marketplace, foreign investors can gain access to United States technology as well as management and marketing skills. Likewise, the United States has an abundance of raw materials and natural resources unavailable in other nations. Through shared technology and resources, foreign firms can enhance their own efficiency and productivity and can become more competitive in the world market.[8] Finally, the current economic condition of the United States is attractive to foreign investors. As the United States dollar depreciates relative to foreign currencies, in particular the Japanese yen, investment in the United States becomes cheaper in terms of foreign currencies. This increased purchasing power of foreign investors, combined with the depressed value of the United States stock market, means that many United

6 GUIDE TO FOREIGN INVESTMENT, *supra* note 4, at 3-5.

7 *The Operations of Federal Agencies in Monitoring, Reporting On, and Analyzing Foreign Investments in the United States (Part 3—Examination of the Committee on Foreign Investment in the United States, Federal Policy Toward Foreign Investment, and Federal Data Collection Efforts): Hearings Before a Subcomm. of the House Committee on Government Operations*, 96th Cong., 1st Sess. 80 (1979)(statement of C. Fred Bergsten, Asst. Sec'y of the Treasury for International Affairs)[hereinafter *Operations of Federal Agencies*].

8 *Acquisitions By Foreign Companies: Hearing on S.907 Before the Senate Comm. On Commerce, Science, and Transportation*, 100th Cong., 1st Sess. 19 (1987)(statement of Malcolm Baldridge, Secretary of Commerce) [hereinafter *Acquisitions by Foreign Companies*].

States businesses can be purchased for less than the total value of their assets.

Foreign investors, however, are not the only ones who benefit: a policy conducive to foreign investment likewise benefits the United States by stimulating the growth of individual companies and expanding the nation's economy. Increased foreign investment helps the United States meet its rapidly growing need for capital. By stimulating the inflow of capital, the supply of capital available to United States businesses is increased, which in turn reduces the cost of acquiring capital from domestic sources. Consequently, United States businesses can expand their productivity and thereby strengthen the growth of the national economy.[9] Furthermore, foreign-owned companies produce the same benefits for the United States economy as domestically-owned businesses, such as employment opportunities, tax revenues and competitively-priced goods and services. Finally, in the same way that foreign entities benefit from United States technology and resources, the participation of those foreign businesses in the United States market also contributes new technology and innovations which induce United States companies to increase their efficiency, productivity and competitiveness.

In addition, maintaining an open investment policy and a climate receptive to foreign capital promotes United States efforts to remove restrictions on investment in other countries. Investors from the United States provide the largest source of capital in the world, and the elimination of investment barriers enhances the ability of United States firms to invest in other nations. This, in turn, enables those nations to earn cash to purchase United States exports and to finance their debts.[10] In the macroeconomy, therefore, an open investment policy can benefit all participants.

Despite the historical commitment of the United States to pursuing a liberal policy open to foreign investment, substantial authority permits the government to regulate or restrict the inflow of foreign capital. Under customary international law, every nation has the sovereign power to restrict the acquisition by aliens of property within its territory.[11] Furthermore, the United States Constitution grants to the federal gov-

---

9 *Id.*

10 *Id.*

11 OECD Draft Convention for the Protection of Foreign Property (1962), *reprinted in* 2 I.L.M. 241 (1963). Furthermore, in the member nations of the Organization for Economic Cooperation and Development (OECD) have declared that the obligations to promote economic development and abolish restrictions on the flow of capital shall not prevent a nation from taking actions necessary to maintain public order or protect its essential security interests. OECD, *Code of Liberalisation of Capital Movements*, Art. III (1982).

ernment specific authority to regulate foreign investment under the foreign commerce clause,[12] and under the provisions establishing the power to conduct foreign affairs[13] and to provide for the national defense.[14]

In response to the growth of the United States economy and the expansion of foreign investment, the United States government developed a framework for foreign investors which promotes the flow of capital while protecting national security interests. A foreign investor who seeks to acquire a controlling interest in a United States company must comply with the same laws and regulatory constraints applicable to domestic investors.[15] However, in addition to the laws which regulate the general conduct of foreign investors in the United States market, the government imposes specific restrictions on foreign investment in industries which are necesary to national defense or public welfare.[16]

III. GENERAL UNITED STATES INVESTMENT REGULATIONS.

A. Antitrust Laws

Foreign investors who attempt to enter the United States market, or increase their current market position by acquiring an existing United States business, must comply with the federal antitrust laws. These laws prohibit unfair aggregations of economic power which might weaken or destroy competition.[17]

Section Seven of the Clayton Act prevents foreign investors, acting singly or collectively, from acquiring, or participating in a merger or joint venture with, a United States firm if the result would substantially lessen competition or tend to create a monopoly.[18] Acquisitions, mergers or joint ventures by foreign investors may similarly be prevented under Sections One or Two of the Sherman Act, if the transactions unreasona-

---

12 U.S. CONST. art. I, § 8, cl. 3. "The Congress shall have Power . . . (3) To regulate Commerce with foreign Nations. . . ."

13 *Id.* at art. II, § 2, cl. 2. "[The President] shall have Power, by and with the Advice and Consent of the Senate to make Treaties. . . ."

14 *Id.* at art. I, § 8, cl. 1. "The Congress shall have Power To . . . provide for the common Defense and general Welfare of the United States . . . ."

15 The two primary investment regulations are the antitrust laws (*see infra* notes 17-23 and accompanying text) and the securities laws (*see infra* notes 24-31 and accompanying text).

16 GUIDE TO FOREIGN INVESTMENT, *supra* note 4, at 157. The areas restricted from foreign investment by specific legislation are: banking, exploitation of natural resources, energy, transportation, communications, and the maritime industry. Roth, *Foreign Investment Regulation in the United States*, 4 CORP. L. REV. 178 (1981)[hereinafter *Foreign Investment Regulation*]. Restrictions on foreign investment in the United States defense industry are authorized by Executive Order 10,865 (*see infra* note 34 and accompanying text).

17 Griffith, *Federal Antitrust Restrictions on Foreign Direct Investment in the U.S.*, in MANUAL OF FOREIGN INVESTMENT IN THE UNITED STATES 22 (J. Marans ed. 1984).

18 15 U.S.C. § 18 (1982).

bly restrain trade or illegally attempt to monopolize a particular market.[19] Section Five of the Federal Trade Commission Act prohibits domestic or foreign-owned businesses from utilizing unfair methods of competition.[20]

Before an acquisition of voting securities, or of assets exceeding a specified amount,[21] may be completed, a foreign investor must notify the Department of Justice and the Federal Trade Commission of the proposed transaction. These enforcement agencies have a statutory time period in which to complete an investigation of the transaction and to ensure compliance with the antitrust laws.[22]

In enforcing the antitrust laws, the Department of Justice makes "no essential distinction . . . between domestic and foreign firms."[23] Thus, while a foreign investor must be able to resist a challenge under any of the applicable antitrust provisions, the antitrust laws impose no stricter standard upon foreign investors than they do upon domestic investors.

B. Securities Laws

A foreign corporation planning to issue securities in the United States market, or obtain a controlling interest in a publicly-held United States company, must comply with the proxy rules and disclosure requirements contained in the Securities Act of 1933[24] and the Securities and Exchange Act of 1934.[25] Among their objectives, these laws require disclosure of significant foreign ownership, prevent fraud and manipulation of stock prices, promote full disclosure of information, and generally preserve orderly markets.

Congress significantly expanded investment disclosure requirements in the 1970's. The expanded requirements enabled the Departments of Commerce and the Treasury to oversee and regulate, but not necessarily restrict, foreign investment activity in the United States.[26] At that time,

19 15 U.S.C. §§ 1, 2 (1982).

20 15 U.S.C. § 45.

21 15 U.S.C. § 18a(a)(3). An acquisition must be reported under the Hart-Scott-Rodino Act only if it would result in the acquiring entity holding at least 15% of the voting securities or assets of the acquired entity, or an aggregate total amount of voting securities and/or assets of the acquired entity in excess of $15 million.

22 Title II of the Hart-Scott-Rodino Antitrust Improvements Act of 1976. 15 U.S.C. § 18a (1982).

23 U.S. DEPARTMENT OF JUSTICE, ANTITRUST GUIDE FOR OPERATIONS 9 (Rev. ed. 1977).

24 15 U.S.C. §§ 77a-77bbbb (1982).

25 15 U.S.C. §§ 78a-78kk (1982).

26 Almond & Goldstein, *Foreign Direct Investment in the United States: An Overview*, 7 N.C.J. INT'L L. & COM. REG. 153, 156 (1982).

Congress took two steps to require more detailed disclosure by foreign investors. First, Congress adopted the International Investment Survey Act of 1976 ("IISA"),[27] which directs the President to compile statistical information concerning foreign direct and portfolio investment in the United States. Accordingly, Executive Order No. 11,961[28] authorizes the Department of Commerce to conduct the direct investment survey and the Department of the Treasury to conduct the portfolio investment survey, with the results reported every five years.[29] Additionally, Congress enacted the Domestic and Foreign Investment Improved Disclosure Act of 1977,[30] which amended the Securities Exchange Act of 1934 to require more complete disclosure by foreign investors holding over five percent of any class of security described in Section 13(d)(1)[31] of the 1934 Act, including the residence and citizenship of the person reporting as well as the nature of any beneficial ownership of securities.

IV. Restrictions on Foreign Investment in the United States Defense Industry.

The United States defense industry is one of the few national interest areas in which foreign participation is restricted. The dangers of giving foreign investors access to national security information as well as the ability to control the production of defense materials outweigh the benefits of unrestricted investment in the defense industry. Although Congress has not adopted any explicit regulations on foreign investment in the defense industry, the Executive Branch has developed a framework of guidelines to regulate such investment. This framework creates a flexible standard to evaluate, and restrict when necessary, foreign investment in the defense industry.[32]

A. The Defense Industrial Security Program

The Defense Industrial Security Program ("Security Program")[33] took effect in 1965, and it established guidelines for granting security clearance to defense contractors owned or controlled by foreign investors. By executive order, President Eisenhower directed the Secretary of Defense to promulgate regulations to safeguard the classified Depart-

27 22 U.S.C. §§ 3101-3108 (1982).
28 Exec. Order No. 11,961, 3 C.F.R. 86 (1977).
29 Guide to Foreign Investment, *supra* note 16, at 16.
30 15 U.S.C. §§ 78m, 78o (1982).
31 15 U.S.C. § 78m(g)(1)(1980).
32 *Foreign Investment Regulation*, *supra* note 16, at 195-200.
33 Department of Defense, Department of Defense Industrial Security Program, Directive 5220.22 (1965).

ment of Defense or national security information made available to United States industries.[34] The Defense Investigative Service ("Service"), a division within the Department of Defense coordinates and enforces the Security Program.[35]

The Industrial Security Regulations ("Regulations")[36] set forth the basic policies and procedures of the program, and the Industrial Security Manual ("Manual")[37] outlines the uniform security practices which all contractors with access to classified information must follow. Any contract for work involving access to such information must include a provision requiring the contractor to execute a security agreement binding the contractor to comply with the procedures set forth in the Manual.[38]

The central focus of the Security Program is that no contractor may receive access to classified information unless the contractor's facility has been granted a security clearance level which meets the security classification level of the information to be disclosed.[39] Furthermore, no subsidiary company may have access to classified information unless its parent company has an equivalent, or higher, clearance level than the subsidiary.[40] The Regulations stipulate that clearance may be granted only to contractors "organized and existing under the laws of the U.S. or Puerto Rico," and any facilities "which are determined to be under foreign ownership, control or influence ("FOCI") are not eligible for clearance."[41] However, a finding of FOCI does not necessarily prohibit the security clearance, for the Regulations identify several methods for negating or

34 Exec. Order No. 10865, 3 C.F.R. 398 (Feb. 20, 1960). The President also directed that the regulations created by the Department of Defense could be adopted by any other federal department or agency as a standard for protecting classified information. *Id.* at § 1(b). *See also Foreign Investment Regulation, supra* note 16, at 189. The following agencies currently subscribe to the security standards established by the Department of Defense: the Departments of Commerce, State, Treasury, Transportation, Interior, Agriculture, Health & Human Services, Labor, and Justice; the National Aeronautics & Space Administration, the General Services Administration, the Small Business Administration, the National Science Foundation, the United States Information Agency, the Environmental Protection Agency, the United States Arms Control & Disarmament Agency, the Federal Reserve System, and the General Accounting Office. DEPARTMENT OF DEFENSE, INDUSTRIAL SECURITY MANUAL FOR SAFEGUARDING CLASSIFIED INFORMATION, Directive 5220.22-M, § I(c)(Dec. 1985).

35 DEPARTMENT OF DEFENSE, Directive 5220.22-M, at § I(d).

36 DEPARTMENT OF DEFENSE, INDUSTRIAL SECURITY REGULATION, Directive 5220.22-R (Dec. 1985).

37 DEPARTMENT OF DEFENSE, Directive 5220.22-M (Dec. 1985).

38 Swennen, *Federal Restrictions on Participation by Foreign Investors in Defense and Other Government Contracts,* in MANUAL OF FOREIGN INVESTMENT IN THE UNITED STATES 181 (J. Marans ed. 1984).

39 DEPARTMENT OF DEFENSE, Directive 5220.22-R, § 2-101.

40 *Id.* at § 2-104(b).

41 *Id.* at § 2-102(a).

reducing the dangers of FOCI.[42]

The greatest obstacle to foreign investment in the defense industry is passing the threshold test for FOCI. There is no standard determination of what constitutes FOCI, and decisions are made on a case-by-case basis.[43] Ultimately, the determination of FOCI is a subjective evaluation, in which the Service has substantial discretionary authority. Under the Regulations, a defense contractor's facility may be denied security clearance when "a reasonable basis exists to conclude that the nature and extent of FOCI is such that foreign dominance over the management or operations of the facility may result in the compromise of classified information or impact adversely the performance on classified contracts."[44]

The factors considered in determining whether FOCI exists include the following: foreign direct or beneficial ownership of 5% or more of an organization's securities; the extent to which foreign interests hold management positions or control or influence directors, officers or executives of an organization; the extent of a company's contracts with or indebtedness to foreign interests; having income from foreign interests which exceeds 10% of gross income; or any further evidence indicating the capability of a foreign interest to control or influence the management or operations of the organization and thereby gain access to sensitive information.[45] Such broad criteria permit the Service wide latitude in making its determinations.

The Regulations specify five steps which may enable a FOCI facility to qualify for security clearance. First, security clearance may be granted to a company controlled by investors from a nation having a Reciprocal Industrial Security Agreement with the United States.[46] These agreements establish arrangements whereby a facility located in one of the signatory countries, but under the ownership, control, or influence of a party from the other country, may be declared eligible for access to classified information. Currently, the United States has such agreements with the United Kingdom, Canada and the Federal Republic of Germany. For a FOCI facility to qualify for clearance on this basis, however, the foreign government of the investing entity must issue a security assurance for that particular company, and the company cannot receive access to classified information which could not be shared between the signatory governments.[47]

---

42 *See infra* text accompanying notes 46-54.

43 Swennen, *supra* note 38, at 184.

44 DEPARTMENT OF DEFENSE, 5220.22-R, § 2-201(a).

45 *Id.* at § 2-202.

46 *Id.* at § 2-205.

47 *Id.*

Second, a company under FOCI may neutralize the effects of foreign ownership by enacting a board resolution. The resolution must identify all foreign shareholders, their representatives, and the extent of their ownership. It must also certify that they and their representatives will be excluded from access to the company's classified information and from any positions which would enable them to influence the company's policies and practices in performing classified contracts.[48] This option requires that the chairman and chief executive officer of the firm be United States citizens, that a foreign interest is not the largest single shareholder, and that identified United States citizens own a majority of the stock.

Third, when foreign investors own the majority interest of a United States company or have effective control over the management, they can establish a Voting Trust Agreement. This procedure insulates the foreign influence by unequivocally transferring legal title in the foreign investor's stock to trustees who are United States citizens approved by the Service. These trustees must not have any prior connection with the company or the investor, yet must hold personnel security clearances permitting access to classified information.[49] The trustees must hold all the management powers derived from the stock ownership and must ensure that the foreign stockholders are insulated from the cleared facility, having no status other than that of a beneficiary.[50]

Fourth, a United States facility may be insulated from minority foreign ownership if the foreign investors convey their voting rights in the stock to proxy holders by an irrevocable proxy agreement. Although the conditions and requirements for the proxy agreement are the same as for a Voting Trust Agreement, the foreign investors retain legal title to the stock while granting all management powers to the proxy holders.[51]

Finally, when a foreign interest owns a majority of the voting stock of a United States firm, or has effective control over operations or management, but chooses not to relinquish that control, the firm, the foreign investor, and the Department of Defense may execute a Special Security Agreement to neutralize the FOCI.[52] Such an agreement is available only (1) when the foreign interest represents a nation having a formal Reciprocal Security Agreement with the United States, when all person-

48 *Id.* at § 2-205(a).

49 Every individual employed by a defense contractor must be deemed eligible, from a security standpoint, for access to classified information. *See* DEPARTMENT OF DEFENSE, Directive 5220.22-R, § 2-302.

50 *Id.* at § 2-205(b).

51 *Id.* at § 2-205(c).

52 *Id.* at § 2-205(e).

nel requiring security clearance are United States citizens, and when the facility clearance is below the TOP SECRET[53] level; or (2) when the foreign investor's nation has a bilateral security agreement with the United States, all personnel requiring security clearance are United States citizens, and the facility clearance is limited to the CONFIDENTIAL level.[54]

Thus, under the authority of the Security Program, the Department of Defense can limit the participation of foreign investors in the defense industry. Although there are no statutory prohibitions to such investment, the Department of Defense has the ability to create a disincentive for foreign investors who propose to acquire ownership of a defense contractor. Faced with the possibility of losing security clearance and thereby its defense contracts, foreign investors are unlikely to pursue investments which no longer would be profitable.

The test of foreign control, however, is a flexible one. By reserving the right to grant security clearance if an investment or acquisition is structured to minimize the impact of foreign ownership, the Department of Defense may refrain from interfering with foreign investment which does not pose a threat to sensitive security information.

B. The Committee on Foreign Investment in the United States

As the amount of foreign investment rapidly increased in the early 1970s,[55] both Congress and the Executive branch began to review foreign investment policy. This review led to the Foreign Investment Study Act of 1974 ("Study").[56] The Study did not signal any change from the traditional open investment policy of the United States, but did serve as the basis for the expanded disclosure requirements implemented in 1977.[57]

In response to the Study's conclusion that foreign investment in the United States was not sufficiently monitored, President Ford created the Committee on Foreign Investment in the United States ("CFIUS", or

53 TOP SECRET is the highest level of security classification, and it applies ony to information or material which would cause "exceptionally grave damage" to national security if it were disclosed without authorization. *See* DEPARTMENT OF DEFENSE, Directive 5220.22-M, at § 3(cl).

54 DEPARTMENT OF DEFENSE, 5220.22-R, at § 2-202(e)(3). CONFIDENTIAL is the second highest level of security classification, and it applies to information or material which could cause "damage" to national security if it were disclosed without authorization. *See* DEPARTMENT OF DEFENSE, Directive 5220.22-M, at § 3(v).

55 Albrecht, *Current Attitudes Toward and Studies of Foreign Investment in the United States*, in CURRENT LEGAL ASPECTS OF FOREIGN INVESTMENT IN THE UNITED STATES 260-61 (D. Evans ed. 1976).

56 15 U.S.C. § 78(b)(1982). This act was the first legislative measure authorizing the collection of foreign investment information.

57 *See supra* text accompanying notes 27-31.

"the Committee").[58] CFIUS is an interagency committee consisting of representatives from the Departments of State, Treasury, Defense, and Commerce, the United States Trade Representative, and the Council of Economic Advisers. The Committee has "primary continuing responsibility within the Executive Branch for monitoring the impact of both direct and portfolio foreign investment in the United States and for coordinating the implementation of United States policy on such investment."[59] In carrying out these functions, the Committee is to consult with foreign governments on significant foreign governmental investments and to review any private investments in the United States which, "in the judgment of the Committee, might have major implications for United States national interests."[60]

Discretionary review is the fundamental authority vested in the Committee, for it has no authority to administer any laws or regulations. Instead, CFIUS assesses the impact of proposed foreign investments and recommends ways to apply existing regulations to eliminate a threat to national security. The Committee has a number of options to ensure that a proposed transaction is consistent with United States national security interests.

When CFIUS determines that an investment by a foreign government may threaten United States national security interests, the Committee relies upon direct consultations between the United States government and the investing government. In 1975, the United States government requested all foreign governments to consult with CFIUS before pursuing any major direct investments in the United States.[61] This consultation process enables the United States government to address most national security concerns through diplomatic measures before the foreign government becomes substanially committed to the investment. By indicating opposition to an investment through diplomatic representations, the United States government can persuade a foreign government either to refrain from investing or to restructure the transaction to isolate the foreign influence.[62]

Even in the case of private foreign investment, the Committee believes that a strong negative reaction by the United States government

58 Exec. Order No. 11,858, 3A C.F.R. 990 (1975).

59 *Id.* at § 1(b).

60 *Id.* at § 1(b)(3). The Committee has specifically refrained from defining what constitutes "major implications for United States national interests," because the factors involved may be numerous and the Committee believes that such decisions should be made on a case-by-case basis. *Operations of Federal Agencies, supra* note 7, at 63.

61 *Operations of Federal Agencies, supra* note 7, at 63.

62 *Id.*

would be sufficient to deter a proposed transaction. If not, however, CFIUS can suggest several policy options. If the transaction would lessen competition or create a monopoly, CFIUS can advise that United States antitrust laws be applied to block the transaction. If the transaction would provide foreign access to classified technology, CFIUS can ensure that the guidelines of the Defense Industrial Security Program are enforced to isolate the foreign influence or revoke the security clearance. Finally, if CFIUS determines that an extraordinary threat to national security, foreign policy or the economy exists, CFIUS can advise the President, under the International Emergency Economic Powers Act ("IEEPA"),[63] to block a foreign acquisition of a United States company or compel the divestiture of foreign interests in an acquired domestic company.

CFIUS was created to monitor the impact of foreign investment in the United States and to coordinate any necessary response. Despite the Committee's lack of direct enforcement authority, by fulfilling its role as a policy coordinating body, the Committee ensures that investments adverse to United States national security interests are limited or prohibited.

V. APPLICATION OF THE EXISTING REGULATORY FRAMEWORK.

During the fall of 1986 and early 1987, the entire range of restrictions on foreign investment was applied when Fujitsu Ltd. ("Fujitsu"), one of Japan's largest computer manufacturers, attempted to acquire California-based Fairchild Semiconductor Corporation ("Fairchild").[64] Fairchild was one of the first semiconductor companies to base its operations in California's Silicon Valley during the 1950s. In 1986, Schlumberger Ltd. ("Schlumberger"), an oil-field services and electronics company based in New York but controlled by French interests, owned Fairchild.[65]

Fairchild is a primary supplier of micro-technology for United States defense contractors, manufacturing sophisticated microchips, called high-speed bipolar gate arrays, critical to the operation and guidance of military weapons, since they can withstand radiation during a nuclear attack.[66] Tokyo-based Fujitsu produces computers and telecom-

63 50 U.S.C. §§ 1701-1706 (1982).

64 Wall St. J., Oct. 24, 1986, at 10, col. 2.

65 Wall St. J., Mar. 13, 1987, at 5, col. 2. Schlumberger purchased Fairchild for $425 million in 1979, Wall St. J., Oct. 24, 1986, at 10, col. 2, and despite an infusion of $1.5 billion, the semiconductor unit remained a serious drain on struggling Schlumberger. Wall. St. J., Feb. 23, 1987, at 24, col. 3.

66 Wall St. J., Nov. 17, 1986, at 40, col. 3.

munications equipment, and specializes in the high volume memory-chips necessary to the computer industry. Fujitsu produces its semiconductor components in Japan and assembles and packages some of the units at its San Diego-based subsidiary, Fujitsu Microelectronics Incorporated.[67] In addition, the Japanese conglomerate at that time owned 48% of Amdahl Corporation, a California-based producer of large mainframe computer systems.[68]

Under the proposed acquisition, Fujitsu would acquire 80% of Fairchild and combine it with Fujitsu's San Diego subsidiary to create the fifth largest semiconductor producer in the world. The transaction would provide Fujitsu with a plant and an established distribution network in the United States, access to research and development, an exemption from some of the pricing and import restrictions imposed on Japanese semiconductor manufacturers, and a 6% share of the United States semiconductor market.[69]

Fujitsu's announcement of its intention to acquire Fairchild sparked an outcry of opposition from representatives in the Reagan administration and from the semiconductor industry.[70] To coordinate the Reagan administration's response to these concerns, CFIUS[71] began meetings in October 1986 to evaluate the benefits and detriments of Fujitsu's proposal, to clarify the extent to which the United States would accept foreign control of companies performing sensitive defense-related work, and to assess the options the United States government would have if it decided to challenge the transaction.[72] At the direction of CFIUS, various departments initiated procedures to review the effects and implications of the transaction upon antitrust concerns, the national security, and overall trade policy considerations.

In accordance with the Hart-Scott-Rodino Act,[73] the Antitrust Division of the Department of Justice commenced a routine merger review.[74] Because both Fujitsu and Fairchild were leaders in the rapidly growing market for gate array systems,[75] the acquisition would consolidate market share and make Fujitsu the number one producer in the gate

---

67 Wall St. J., Oct. 24, 1986, at 10, col. 2.

68 Wall St. J., Oct. 27, 1986, at 6, col. 1.

69 N.Y. Times, Dec. 29, 1986, at 4, col. 2.

70 Wall St. J., Oct. 31, 1986, at 8, col. 2.

71 *See supra* text accompanying notes 55-63.

72 *See* Wall St. J., Oct. 31, 1986, at 8, col. 2, and Dec. 29, 1986, at 4, col. 2.

73 *See supra* notes 18, 21-23, and accompanying text.

74 Wall St. J., Nov. 17, 1986, at 40, col. 3.

75 Gate array systems are the programmable microchips which perform specific mathematical or logical functions in computer systems. *See* Wall St. J., Oct. 27, 1986, at 6, col. 1.

array market.[76] Although the antitrust division ultimately did not complete a determination on the impact of the merger on competition,[77] no antitrust violations may have occurred, because Fujitsu's main business focus is on memory chips which store data, while Fairchild's focus is on the logic chips which manipulate the data.[78]

Because approximately 40% of Fairchild's products are sold to primary defense contractors such as Rockwell International Corporation, Hughes Aircraft, and Raytheon Company, the Department of Defense undertook a review of the effects the transaction would have on national security and defense contracting.[79] This investigation focused upon potential violations of the Defense Industrial Security Program[80] which would occur if Japanese investors gained majority control over a defense contractor and subsequently had access to defense information and technology.[81] During 1986, Fairchild performed approximately $150 million of government contract work on semiconductors, one-third of which was proprietary work which other companies could not have replicated.[82] Military officials in the Department of Defense were concerned that Fujitsu could not be trusted to protect the classified defense technology made available to Fairchild in performing defense contracts.[83]

Those officials also feared that if a national emergency should arise, the United States must have enough control over domestic production to ensure an adequate supply of the microchips.[84] These officials worried that if a Fujitsu-controlled Fairchild shifted away from the military business to focus on more profitable civilian projects, the United States would no longer be able to manufacture the microchips on its own.[85]

Although the government does not possess the legal authority to

---

76 *Id.*

77 *See infra* text accompanying notes 92-94.

78 Wall St. J., Nov. 17, 1986, at 40, col. 3.

79 Wall St. J., Dec. 29, 1986, at 4, col. 2.

80 *See supra* note 33 and accompanying text.

81 N.Y. Times, Mar. 17, 1987, § 1, at 1, col. 1. When French-investor-controlled Schlumberger purchased Fairchild, there was much less opposition to the sale, although Fairchild did lose its top-secret security clearance. *See* WALL ST. J., Feb. 23, 1987, at 24, col. 3. In fact, one Department of Defense official indicated that the national security concerns of Fairchild's sale could be eliminated if it were acquired by a company controlled by investors from a NATO country. Wall St. J., Nov. 17, 1986, at 40, col. 3.

82 Wall St. J., Mar. 17, 1987, at 3, col. 1.

83 Wall St. J., Dec. 29, 1986, at 4, col. 2.

84 Wall St. J., Oct. 31, 1986, at 8, col. 2.

85 Wall St. J., Dec. 29, 1986, at 4, col. 2. This was of particular concern in late 1986 when there were persistent rumors that Japanese-based Hitachi Co. was seeking to acquire Motorola, Inc., the only other major United States manufacturer of these critical microchips. *Id.*, Oct. 31, 1986, at 8, col. 2.

prevent an acquisition on national security grounds, the Department of Defense does have the ability to impede a transaction or nullify its benefits if defense-contracting security requirements are not met.[86] It is possible that the national security threats could have been eliminated if the defense-related portions of the firm were separated from the rest of the business and managed solely by United States citizens. If that were accomplished, Fujitsu would benefit from the profits of the firm but would not be allowed access to the technology.[87]

A final area of concern with Fujitsu's proposed acquisition of Fairchild was the implication for overall United States trade policy. Several federal agencies expressed concern that Fujitsu's proposal might indicate the commencement of a Japanese attempt to dominate the United States semiconductor industry. If the United States computer industry continues to slump, other United States manufacturers could become takeover targets.[88] Members of government and industry strongly opposed the acquisition because it came "at a time when Japanese semiconductor firms ha[d] been accused of dumping computer chips in [United States] markets at prices lower than it cost to make them."[89]

Similarly, because of the competition between the Japanese and United State manufacturers in the computer industry, there was strong opposition to allowing the Japanese greater access to United States research and development technology. In particular, with Japan's competitiveness in non-military semiconductor technology, United States government and industry officials opposed giving a Japanese company access to an area of strength for United States producers.[90] Furthermore, the Secretary of Commerce at that time expressed concern that the acquisition would enable Fujitsu to use Fairchild's distribution network to market its own Japanese-made supercomputers, while the Japanese government continued to impose strict limitations on the ability of United States companies to market supercomputers in Japan.[91]

Ultimately, none of the departments issued any formal conclusions on the impact of the transaction, for in March 1987, Fujitsu abruptly withdrew its offer to acquire Fairchild.[92] By that time, opposition to the acquisition had coalesced within the Executive Branch, primarily be-

86 *See supra* text accompanying notes 39-42.
87 Wall St. J., Oct. 31, 1986, at 8, col. 2.
88 Wall St. J., Dec. 29, 1986, at 4, col. 2.
89 Wall St. J., Mar. 17, 1987, at 3, col. 1. United States companies estimated that this practice produced losses for domestic companies exceeding $1 billion. *Id.*
90 Wall St. J., Nov. 17, 1986, at 40, col. 3.
91 Wall St. J., Mar. 13, 1987, at 5, col. 2.
92 Wall St. J., Mar. 18, 1987, at 2, col. 2.

cause of United States national security concerns as well as the continuing trade disputes with Japan.[93] Confronted with such strong opposition, Fujitsu decided not to proceed with the transaction, stating that "going through with the deal by force is not our way. . . . We don't want to invest. . . if it isn't welcome."[94] In sum, the Fujitsu incident demonstrates that, although CFIUS does not have any legal authority to block investments, by exerting public and diplomatic pressure on foreign interests, the Committee can create an unfavorable climate for foreign investors. The presence of an unfavorable environment will thereby protect United States national security interests from harmful foreign investment.

VI. THE EXON AMENDMENT.

Although Fujitsu ultimately abandoned its attempt to acquire Fairchild, the incident highlighted the potential shortcomings of United States policy for controlling foreign investment in national interest sectors such as defense procurement. Members of Congress, the Reagan administration, and leaders of United States industry raised concerns about the apparent lack of authority to prevent foreign acquisitions of security-sensitive United States businesses and renewed the movement to restrict foreign investment in the defense industry. The result of this drive is Section 5021 of the "Omnibus Trade and Competitiveness Act of 1988" ("Exon Amendment").[95] The provision, entitled "Authority to Review Certain Mergers, Acquisitions and Takeovers," establishes a mechanism to investigate mergers, acquisitions or takeovers of any United States domestic corporation by foreign investors and provides the authority to suspend or prohibit such a transaction if it might endanger or impair national security.

The enacted version of the Exon Amendment represents the culmination of nearly two years of Congressional deliberation. A joint conference committee of the House and Senate ("Conference Committee") drafted the legislation to reconcile the differing proposals that the House of Representatives and the Senate had previosly adopted. The House bill[96] mandated that the Secretary of Commerce, upon his own initiative or at the request of any agency head, investigate any merger, acquisition, joint venture, licensing or takeover by or with foreign companies which

---

93 *Id.*

94 *Id.*

95 Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, § 5021, 102 Stat. 1107, 1425 (1988).

96 H.R. 3, 100th Cong., 1st Sess., § 905 (1987)[hereinafter H.R. 3 (House Version)].

involve United States companies participating in interstate commerce, and assess the effects of the transaction upon national security, essential commerce, and economic welfare.[97] If the investigation demonstrated that foreign control of firms engaged in interstate and foreign commerce would threaten to impair national security and essential commerce, the President must take whatever action he considers appropriate, unless he determines that no threat to national security or essential commerce exists. With such a broad and ambiguous standard as "national security, essential commerce and economic welfare," the House bill seemed to have been aimed at precluding foreign investment altogether in businesses even remotely connected to United States national security, and thus appears to be a form of trade protection implemented under the guise of national security concerns.

In contrast, the Senate sought to amend ("Senate version")[98] the House bill by granting the Secretary of Commerce discretionary, rather than mandatory, power to initiate investigations only upon the request of Cabinet-level department heads, and to limit the criteria for review to "national security or essential commerce which affects national security."[99] Furthermore, the provision was drafted as an amendment to Title VII of the Defense Production Act of 1950,[100] and applied only to mergers, acquisitions or takeovers. While the provision granted the President full discretion as to whether to act on the Secretary's recommendation, it nevertheless did require that the President report the results of each investigation to Congress. It also gave Congress the option to enact a joint resolution preventing the President from acting to restrict, suspend or prohibit the transaction. Although the Senate version had a greater focus on national security than the House bill, it nevertheless created an arbitrary and ambiguous authority which could have made the investment climate more uncertain for foreign investors and would likely have undermined the open investment policy.

In an effort to eliminate some of the ambiguity and the broad scope of the original proposals, the Exon Amendment states that the President, or his designee, within thirty days after receiving written notice of a proposed or pending merger, acquisition or takeover, "may make an investigation to determine the effects on national security."[101] Such an investigation must be completed within forty-five days after the President

97 H.R. 3 (House Version) at § 907.

98 H.R. 3, 100th Cong., 1st Sess., § 1401 (1987)[hereinafter H.R. 3 (Senate Version)].

99 *Id.*

100 50 U.S.C. App. § 2158 *et seq.* (1982).

101 Defense Production Act of 1950 (as amended) § 721(a), 50 U.S.C. App. § 2158 *et seq.*

determines that the investigation is necessary. If the investigation indicates that there is "credible evidence" that the foreign interest exercising control might take action that threatens to impair national security, and no other provisions of law—other than IEEPA[102]—provide adequate authority to protect national security, then the President may take any action, for such time as he considers appropriate, to suspend or prohibit the transaction.[103]

On December 27, 1988, President Reagan issued Executive Order 12,661,[104] which empowers CFIUS to undertake and coordinate the investigations under the Exon Amendment, and to report the results to the President. In addition, the President directed the Department of the Treasury to issue regulations necessary to implement Section 721 of the Defense Production Act.[105]

In reporting on the Senate version, the Senate Committee on Commerce, Science and Transportation stated that the amendment was not intended to impose barriers to foreign investment, "nor to have any effect on transactions which are clearly outside the realm of national security."[106] Furthermore, Senator James Exon (D-NE), the sponsor of the amendment, emphasized that the "legislation does not compel any action, it simply prevents future Presidents from throwing up their hands and saying 'I cannot do anything,' while America's national security industries and technologies fall under foreign control."[107]

Despite those statements that the Senate version had a limited scope and purpose, its breadth and ambiguity seemed to create authority directed more towards protecting United States businesses from foreign investors rather than protecting true national security interests. Congress is correct to recognize that the government should have the authority to review investments and prevent the control of United States companies by foreign entities, where that control would have a direct adverse effect on the national security of the United States. However, any attempt to revise or redefine United States policy on foreign investment must be measured against the overall goal of United States investment policy.

Foreign investment plays an essential role in the economic development of the United States. Therefore, our investment policy should promote and strengthen an economic environment which is conducive to

---

102 *See* note 63, *supra*, and accompanying text.

103 Defense Production Act of 1950, § 721(c); 50 U.S.C. App. § 2158 *et seq.*

104 Exec. Order No. 12,661, 54 Fed. Reg. 779 (1989).

105 *Id.* at 781. At publication time, the regulations were not yet available, but they are expected to be promulgated during early 1989.

106 S. REP. No. 80, 100th Cong., 1st Sess. 25 (1987).

107 133 CONG. REC. S9696 (daily ed. July 10, 1987)(statement of Sen. Exon).

inflows of foreign capital. Any change in policy must be evaluated for its impact on the domestic economy. In addition, Congress must consider the way in which foreign investors will perceive changes in United States investment policy and how those perceptions will affect foreign investment decisions.

To meet these challenges, any legislative attempt to restrict foreign investment requires careful deliberation and should not be an impulsive reaction to temporarily unfavorable market conditions. The restrictions on foreign investment which were implemented in the past were tailored to specific industries, such as telecommunications, aviation and natural resources. If restrictions based upon such a broad concept as national security are to be implemented, they must be developed "systematically, taking into consideration our existing domestic regulatory framework as well as our international obligations."[108]

Congress should not take any action which would discourage foreign investment in the United States, either intentionally or inadvertently. The United States has always been a favorable market for foreign capital, and investors have been attracted by the stability and openness of its social, political and economic framework.[109] However, by establishing broad legal authority to block foreign investments, both original legislative proposals would have signaled to current and potential foreign investors that the United States is altering its traditional attitude toward such investment.

Such a change would be dangerous, for the attitude—whether real or perceived—of a host government toward foreign investment is an important factor in an investor's decision to invest in a particular country.[110] An investor who confronts the possibility that the government may step in at any time and disapprove a transaction is likely to pursue alternate investments—not only in other industries, but also in other countries. A policy which adds uncertainty to the investment climate creates more risk for an investor, and can deter foreign investment in other sectors of the economy.

Even the Senate version, which was less protectionist than the House bill, failed to take account of those necessary considerations and, consequently, would have created a riskier environment for investors, duplicated much of the authority already in effect, and might have induced retaliatory restraints on United States investment in other nations. The

108 *Acquisitions by Foriegn Companies, supra* note 8, at 52 (Statement of Robert L. McNeill, Executive Vice Chairman, Emergency Committee for American Trade).

109 *See supra* text accompanying notes 7-10.

110 *Operations of Federal Agencies, supra* note 7, at 65.

net effect of the Senate version would likely have been to undermine the very features which make the United States an attractive market for foreign investment, while providing no more substantive protections than are available under the existing restrictions.

The Conference Committee appears to have recognized the protectionist nature of both original proposals. As a result, the enacted version of the Exon Amendment attempts to restrict foreign investment which truly threatens United States national security interests without instituting protectionist barriers which might deter the flow of capital into the United States and also lead to retaliatory restrictions against United States investments overseas. Specifically, the Exon Amendment includes provisions which impose a more definite time period during which CFIUS may initiate an investigation, which limit the scope of authority to true threats to national security, and which limit the discretionary power of the President by requiring that it not be applied unless existing legal authority is insufficient to deter the threat to national security.

One of the central drawbacks of the Senate version was its failure to indicate when the Executive branch could initiate the transaction reviews. This proposal specified no time frame within which to begin a review, and it did not preclude the government from undertaking such national security reviews even after the transaction had been completed. Unlike antitrust reviews, which the general investment disclosure requirements trigger automatically, this power of review was entirely discretionary.

Investors, therefore, could not anticipate when, or if, the United States government might initiate a national security review. With that constant risk of governmental interference, investors would be less likely to expend time, money and resources in pursuing such investment. In an uncertain investment environment, fearful investors refrain from investing, whether or not their fears are legitimate.

In contrast, the Exon Amendment establishes a new practice, whereby written notice must be filed with CFIUS describing proposed or pending mergers, acquisitions and takeovers which could lead to foreign control of United States companies.[111] If CFIUS determines that the information provided indicates that the transaction may affect national security, CFIUS may begin an investigation. However, the Amendment requires that the investigation be initiated within thirty days after receiv-

[111] Although neither the Exon Amendment nor the Executive Order establish a specific notification process, the regulations which the Department of Treasury will promulgate will presumably set forth the requirements with which foreign investors must comply to notify CFIUS of the transaction and thereby trigger an Exon Amendment review.

ing written notice of the proposed or pending transaction. The Executive Order establishing CFIUS' authority to act under the Exon Amendment requires that a decision by CFIUS not to investigate a proposed transaction must be unanimous. Such a unanimous decision by CFIUS not to investigate terminates all authority to review that particular transaction, and the investors may proceed uninterrupted. If, however, CFIUS is unable to reach a unanimous decision not to investigate, the chairperson of CFIUS, within twenty-five days after receiving notice of the pending transaction, must submit a report to the President on the relevant issues and the differing views of CFIUS. The President must then determine, within the prescribed thirty day decision period, whether to initiate an investigation.[112]

By imposing a strict thirty day period in which to determine whether an investigation is necessary, the Conference Committee sought to eliminate the uncertainty and ambiguity present in the original Senate bill. Such a limit makes it clear to foreign investors that all transactions will be studied, at least preliminarily, but that a decision to investigate will be made within thirty days and that no investigation may be initiated after the decision period expires. Furthermore, the Exon Amendment requires that if CFIUS or the President does conclude that an investigation is necessary, the investigation must be completed within forty-five days after the determination to proceed with the investigation. This time requirement again helps to eliminate uncertainty for the investors. Thus, an investor will receive a decision on the transaction involved no later than seventy-five days after CFIUS was first notified of the proposed transaction.

Another significant problem with the Senate version was that the breadth of factors to be considered in evaluating a foreign investment appeared to establish a scope beyond merely its effect on national security. The proposal specified that the President "shall" consider domestic production requirements,[113] the "availability of [domestic] human resources, products, technology, [and] raw materials,"[114] and "the capacity of the United States to meet the requirements of national security and essential commerce which affects national security."[115] The term "essential commerce" is vague and imprecise, and the text of the amendment provided no clarification of its meaning. Establishing such an ambiguous standard of review would have created the possibility that the Senate ver-

112 Exec. Order No. 12,661; 54 Fed. Reg. at 781 (1989).
113 H.R. 3 (Senate Version), § 1401 (721-e-1).
114 H.R. 3 (Senate Version), § 1401, (721-e-2).
115 H.R. 3 (Senate Version), § 1401 (721-e-3).

sion might be applied not only to shield classified information from foreign investors, but also to prevent foreign investors from acquiring successful United States businesses. Moreover, by measuring a proposed investment against the ability of domestic companies to fulfill defense contracts, the President would be able arbitrarily to block foreign investment in the United States for reasons unrelated to the protection of information pertaining to United States national security.

The Senate version would have done more than create a basis of authority to prevent foreign entities from acquiring control over sensitive national security industries. Indeed, the amendment would have given the President unprecedented discretionary power to protect domestic businesses from their foreign competitors.

The protectionist character of the Senate version is contrary to the United States traditional open investment policy. It would have allowed almost any type of business to seek protection from foreign investors under the "essential commerce affecting national security" provision.[116] As a result, domestic companies would have been able to pressure the Executive Branch to conduct investigations to delay or prevent otherwise legitimate transactions. Legislation which creates such ambiguous and arbitrary authority makes the United States investment climate more uncertain, and discourages foreign investment in the United States.

The Conference Committee apparently recognized the dangers of having such a broad, ambiguous scope of review, and instead reconstructed the legislation with slightly more of a specific focus on national security. While the Exon Amendment does not limit the factors which may be considered in assessing the effects of the transaction on national security, it does emphasize three principal factors:

(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, and
(3) the control of domestic industries and commercial activity by foreign citizens as it affects the capability and capacity of the United States to meet the requirements of national security.[117]

These factors are very similar to the ones included in the original Senate version, yet the Exon Amendment does not authorize an assess-

[116] At the Senate hearing on this amendment, Commerce Secretary Baldridge expressed concern that the "essential commerce" provision could enable businesses only remotely connected to defense procurement and national security, such as the suppliers of shoes or buttons for the military, to qualify for protection from foreign investors. *See Acquisitions by Foreign Companies, supra* note 8, at 50.

[117] Pub. L. No. 100-418, § 5021 (1988).

ment of the impact on "essential commerce" and thereby redirects the focus of the legislation towards true threats to national security. Furthermore, the Amendment requires a finding of "credible evidence" that the transaction would impair national security before the President may take any action against the transaction. The Conference Committee members emphasized that they "in no way intend to impose barriers to foreign investment" and that the Exon Amendment "is not intended to have any effect on transactions which are outside the realm of national security."[118]

However, the Conference Committee also stated that "the term 'national security' is intended to be interpreted broadly," that the term is not meant to imply any limitation on the term "national defense" as used elsewhere in the Defense Production Act, and that, in the past, the term "national defense" has been correctly interpreted "to include the provision of a broad range of goods and services, as well as technological innovations and economic stabilization efforts."[119] While these statements raise the possibility that the investigatory authority could be applied broadly, the overall focus of the Exon Amendment appears to be solely upon protecting national security, and those assertions appear intended only to provide broad authority to protect national security rather than to create authority which can be applied to broad areas of commerce.

By focusing more specifically upon factors relevant to national security, the Exon Amendment emphasizes that the true intent of the amendment is to protect sensitive national security information and facilities from foreign control, and, in turn, lessens the danger that a President could arbitrarily use the Amendment as a tool to protect United States companies from foreign investors, regardless of the existence of any threats to national security.

Another significant problem with the Senate version, which has been carried into the Exon Amendment, is that the authority granted to the President duplicates some procedures of the current investment policy and undermines others. CFIUS already has the authority to investigate, on its own initiative or at the request of any agency or department, any proposed transaction which "might have major implications for United States national interests."[120] Thus, the authority to review investments already exists within the Executive Branch. However, while the Senate version required that the results of every investigation be submitted to

118 OMNIBUS TRADE AND COMPETITIVENESS ACT OF 1988, CONFERENCE REPORT TO ACCOMPANY H.R. 3, H. R. CONF. REP. No. 576, 100th Cong., 2d Sess. 1959 (1988).

119 *Id.* at 1959-60.

120 Exec. Order No. 11,858, 3 C.F.R. 990 (1976).

the President for review, the Conference version, as implemented by Executive Order 12,661, requires presidential review only when CFIUS is unable to reach a unanimous decision on an investigation. This is a better alternative, for if the investigation demonstrates no danger to national security, or if the security threats can be eliminated without needlessly delaying the transaction, presidential review should not be required. In the past, CFIUS has made a practice of only submitting the most threatening investment proposals for Cabinet-level consideration, for the "overwhelming majority simply do not merit a higher level of review."[121]

Nevertheless, even the Exon Amendment's proposed review system places constraints on the very process which CFIUS now uses to review investments; namely, negotiations with the foreign investors. By working with the investors, CFIUS provides advice on ways to structure the transaction in order to minimize any threat to national security without discouraging foreign investment. In addition, the Defense Industrial Security Program specifically permits foreign investment in defense industries when arrangements can be made to isolate sensitive information from foreign control.[122] The central problem with establishing a fixed time limit in which to complete an investment review is that it works against those transactions where intergovernmental consultations, or an acceptable transaction arrangement, are not easily completed. A policy which imposes time limitations upon situations best resolved through negotiated settlements can create a hostile environment for foreign investment.

Finally, permitting the President to exercise broad authority to block investments sends an improper signal to other governments, and threatens recent United States efforts to remove barriers to trade and investment in other nations. The United States is the leading proponent of open investment policy throughout the world, and numerous non-governmental organizations assist the United States government in promoting the free flow of trade and capital throughout the world.

Implementing a policy contrary to the open investment principles to which the United States has traditionally adhered will induce "a major corrosive effect on other countries and tend to legitimize current and new interventions in international investment on their part."[123] Such a retaliatory effect would significantly harm United States investors, for the United States invests more capital overseas than any other nation. Thus,

---

121 *Acquisitions by Foreign Companies, supra* note 8, at 20 (Statement of Commerce Secretary Baldridge).

122 *See supra* text accompanying notes 46-54.

123 *Operations of Federal Agencies, supra* note 7, at 66.

by undertaking a policy which permits broad government interventions in international investment, the United States risks losing much more than it gains.[124]

VII. Conclusion

Substantial authority exists within the current framework of laws and regulations to restrict foreign investment which threatens United States national security interests. The Exon Amendment attempts to consolidate the implementation of that authority within the Executive Branch. The Exon Amendment seems to establish a new process that CFIUS be notified of every proposed merger, acquisition or takeover which could result in foreign control of businesses engaged in interstate commerce in the United States. However, the Amendment is drawn more narrowly than the initial House and Senate proposals, and the statements of the Conference Committee express the intent that the Amendment is not meant to impose any limitations on foreign investment which does not threaten national security interests.

To ensure that the authority granted by the Amendment is not applied to block transactions which do not threaten national security, the regulations promulgated under the authority of the Amendment must clearly specify how it will be applied and what is required of investors. If the regulations are not clear and focused, foreign investors may fear arbitrary actions by the United States government. The Amendment broadly defines national security, and, therefore, the regulations must ensure that the power to investigate foreign investment does not become a tool to protect United States business from foreign competition.

President Bush has indicated that his administration is committed to pursuing a strong policy of open investment. Nevertheless, foreign investment can present very real national security implications, and the risks which can result from increased foreign investment in defense-related businesses often conflict with a commitment to the free market. This complex issue involves contradictory factors such as trade policy, free market principles, the need to maintain the commercial strength of strategically important defense contractors, as well as the ability to mobilize those businesses in the event of a national emergency. To maintain the historical commitment to an open investment policy, and to keep the domestic economy competitive and efficient, a policy which is intended to limit national security risks should encourage the inflow of foreign capital, while simultaneously restricting the access of foreign investors to

---

124 *Id.*

sensitive defense information and technology. The policy should be consistent with the goals of the Defense Industrial Security Program, which permit foreign investment in sensitive industries when adequate security precautions are implemented.

Only if the regulations which implement the Exon Amendment are consistent with the expressed legislative intent that the power to suspend or prohibit transactions should only be applied when true threats to national security interests exist which cannot be protected by other authority, and if CFIUS exercises restraint in not using its investigatory power to deter foreign investments which do not truly threaten national security, will the Exon Amendment succeed as an effective tool to protect national security interests without creating an unfavorable environment for foreign investment.

Mark L. Hanson