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NATIONAL SECURITY REVIEW OF FOREIGN INVESTMENT IN THE UNITED STATES: AN UPDATE ON EXON-FLORIO AND THE FINAL REGULATIONS WHICH IMPLEMENT IT

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I. INTRODUCTION

While the United States takes pride in generally maintaining an "open door" to foreign investment, concern that foreign control of certain types of businesses could threaten "national security" led Con-

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gress in 1988 to enact legislation which empowers the President to take action against foreign acquisitions of U.S. businesses in certain limited cases. The law is commonly referred to as the "Exon-Florio" provision because it was authored by U.S. Senator James Exon of Nebraska and then-Representative James Florio of New Jersey.[1] Under Exon-Florio, the President can prevent or obtain divestiture of any acquisition, merger or takeover (hereinafter referred to collectively as "acquisition") of a United States business by a "foreign person" if the President finds "credible evidence:" 1) that the acquisition may result in a foreign interest exercising control over the U.S. entity, and 2) that such "foreign" control might lead to "actions that threaten to impair [U.S.] national security."[2] Some members of Congress had advocated a broader provision which could block foreign acquisitions that threatened the "essential commerce" of the United States even if the foreign acquisitions had no recognizable impact on national security.[3] However, this broader view was ultimately rejected.

Although Exon-Florio was enacted as an amendment to the Omnibus Trade and Competitiveness Act of 1988, as a procedural matter it created a new section 721 to the already existing Defense Production Act (DPA).[4] Section 721 was made permanent on August 17, 1991.[5] Acquisitions subject to Exon-Florio include both proposed and completed acquisitions which could result in foreign control of a "U.S. person." Accordingly, the threshold issue is whether the acquisition could result in foreign control of an on-going, sustainable business in the United States.

The U.S. government interagency body charged with conducting the initial review of acquisitions covered by Exon-Florio is the Committee on Foreign Investment in the United States (CFIUS). CFIUS was created in 1975 by a presidential order to monitor the impact of foreign investment in the United States. CFIUS is chaired by a representative from the United States Department of the Treasury, and the staff director is a Treasury official. Representatives of the United States Commerce, State, Defense, and Justice Departments, the Office of Management and Budget (OMB), the Council of Economic Advisers

1. *See generally* 50 U.S.C. App. § 2170 (1988).
2. 50 U.S.C. App. § 2170(c) (1988).
3. House Conference Report No. 100-576; *see* 1988 U.S.C.C.A.N. 1547.
4. 50 U.S.C. App. § 2170 (1988).
5. The Exon-Florio provision expired October 20, 1990, when Congress adjourned without reauthorizing the DPA. Despite this procedural lapse, U.S. government national security review of acquisitions of U.S. companies by foreign interests continued. Because Exon-Florio is now permanent, such a procedural lapse will not occur again.

(CEA), and the Office of the U.S. Trade Representative (USTR) also participate in CFIUS. The fact that these governmental agencies occasionally have conflicting legislative mandates can produce differing opinions within CFIUS regarding appropriate action on particular acquisitions.

In July 1989, the Treasury Department's Office of International Investment issued proposed interim regulations to implement Exon-Florio.[6] On November 21, 1991, that same office issued final regulations.[7] While the final regulations do not substantively change Exon-Florio, they clarify the definition of key terms and the application of Exon-Florio to particular types of activities. The final regulations also reflect and respond to comments made to the Office of International Investment by "over seventy parties — including private and public, as well as domestic and foreign entities" — who filed some 500 pages of comments.[8]

After discussing the roles of both CFIUS and the President in implementing Exon-Florio and the meaning of "national security" as that term applies to Exon-Florio, this article examines the final regulations' attempt to clarify the following terms: 1) "foreign person," 2) "control," and 3) "U.S. person." The article then examines the final regulations' effort to clarify the circumstances under which Exon-Florio will be applied to: 1) joint ventures in which at least one participant is a foreign person, 2) loan transactions which involve foreign lenders who take a security interest in property of a U.S. person, 3) proxy contests which involve one or more foreign persons, and 4) acquisitions of U.S. business' assets which involve a foreign person.

The article concludes with a review of CFIUS' and President Bush's application of Exon-Florio to foreign acquisitions of U.S. companies. Consideration of these investigations is worthwhile for anyone who is concerned with whether a proposed acquisition will be challenged by CFIUS and ultimately blocked by the President. In fact, on only one occasion has President Bush employed Exon-Florio to obtain divestiture of an acquisition. However, eleven other acquisitions have been subject to full investigations by CFIUS. In each case, President Bush either adopted CFIUS' recommendation that the proposed acquisition

6. 54 Fed. Reg. 29744 (1989, Dep't Treas.).

7. 56 Fed. Reg. 58774 (1991, Dep't Treas.). These regulations will appear in 31 C.F.R. Part 800 (___). The final regulations were principally authored by the Treasury Department's Office of the Assistant General Counsel for International Affairs, but also reflect input from other Treasury Department personnel and from other CFIUS member agencies. *Id.* at 58780.

8. 56 Fed. Reg. at 58774.

not be disturbed, or the parties to the acquisition voluntarily abandoned or modified the transaction to alleviate national security concerns.

II. IMPLEMENTATION OF EXON-FLORIO: THE ROLE OF CFIUS AND THE PRESIDENT

In implementing Exon-Florio, CFIUS is responsible for conducting the preliminary review of a proposed or completed acquisition, and, if deemed necessary, transforming the review into a full-scale investigation. To date, CFIUS has conducted hundreds of preliminary reviews and twelve full-scale investigations.[9]

CFIUS may commence a review of a proposed or completed acquisition only if there has been either "agency" or "voluntary" notice. Agency notice occurs when one of the CFIUS member agencies informs CFIUS about the acquisition. By contrast, voluntary notice occurs when one or more of the parties to the acquisition submits certain details about the acquisition to CFIUS in writing. The specific requirements for voluntary notice are set forth at 31 CFR § 800.402.[10]

The final regulations stipulate that if the parties to an acquisition "jointly submit a voluntary notice," they must "provide in detail" the information required by the regulations. In addition, the information must "be accurate and complete with respect to all parties," and each party must sign a joint notice of the acquisition.[11] If "fewer than all the parties to an acquisition submit a voluntary notice," each notifying party must provide the information required by the regulations "with respect to itself and, to the extent known or reasonably available to it, with respect to each non-notifying party."[12] Compliance with this requirement is important because CFIUS may delay acceptance of a notice — and the beginning of the review period — "to obtain any information [required by the regulations] that has not been submitted by the notifying party."[13]

Once CFIUS accepts the notice, the time periods for CFIUS and presidential review begin to run. From the time it receives notice, CFIUS has thirty days to determine whether a full-scale investigation is warranted. If CFIUS decides that an investigation is required,

9. Stephen Canner, Address at the Japan Trade Seminar, sponsored by Washington Int'l Trade Assoc. (Oct. 22, 1991).

10. *See also* 56 Fed. Reg. at 58785-86.

11. 31 C.F.R. § 800.402(a) (___).

12. 31 C.F.R. § 800.402(b)(1) (___).

13. 31 C.F.R. § 800.402(b)(2) (___).

CFIUS then notifies the parties of that fact and has forty-five days to complete its investigation. During the investigation, CFIUS may request additional information and meet with the parties regarding the acquisition. Following the investigation, CFIUS makes a recommendation to the President whether to block, divest or otherwise interfere with an acquisition. Parties may request withdrawal of their notification at any time prior to the announcement by the President of a decision. Generally, CFIUS has granted such requests in the past.[14]

Significantly, the final regulations provide a new limitation on the government's ability to review completed transactions. If CFIUS provides advice in writing that a notified transaction is not subject to Exon-Florio (e.g., because the transaction would not result in foreign control of a U.S. business), such a determination is final and binding with respect to the transaction "as long as the information on which that determination is based is accurate with respect to the transaction."[15]

However, if CFIUS recommends that the President should take some action with respect to an acquisition, the President has fifteen days to make a decision. The law provides that the President may only interfere in the acquisition if two conditions are met. First, there must be "credible evidence that leads the President to believe that the foreign interest exercising control might take action that threatens to impair the national security."[16] CFIUS' recommendation to the President on this issue is often based on the acquiring firm's past behavior. In determining whether "credible evidence" exists, the Departments of Commerce, Defense and State search their export control records for licensing and enforcement information and the U.S. intelligence agencies investigate the foreign firm's history regarding unauthorized technology transfers.

The second requirement for Presidential action is a finding that no U.S. laws, other than Exon-Florio or the International Emergency Economic Powers Act, "provide adequate and appropriate authority for the President to protect the national security . . . ."[17] In making its recommendation to the President, CFIUS looks to the Export Administration Act, the Defense Production Act and the antitrust laws to ensure that this requirement is met.[18] However, those laws

14. Canner, *supra* note 9.
15. 31 C.F.R. § 800.601(d) (____); *see* 56 Fed. Reg. at 58778.
16. 31 C.F.R. § 800.601(b)(1) (____).
17. *Id.*
18. 56 Fed. Reg. at 58777.

have a material shortcoming for Exon-Florio purposes in that none protects against a foreign-owned firm's decision to close down a U.S. factory or to change the firm's product line or research direction.

Despite several requests to do so, CFIUS opted not to adopt a "fast track" procedure for reviewing voluntary notices. However, the preamble to the final regulations reiterates what the authors have found to be the typical practice: that CFIUS' staff chairman "is available to discuss proposed transactions with parties contemplating notice."[19]

CFIUS also declined to provide "fast track" treatment for "notified transactions involving hostile parties."[20] Several commenters on the proposed regulations requested such treatment because of their concern that CFIUS review could "unfairly give a target company time to thwart an unsolicited bid."[21] However, CFIUS did attempt to reassure the public that it would "not tolerate attempts [by a target or other entity] to delay or obstruct" its review process.[22]

If notice of an acquisition subject to Exon-Florio is not provided to CFIUS, either by one of the parties or by an agency, that acquisition remains indefinitely subject to review and ultimately to divestiture or other appropriate action by the President. Comments on the proposed regulations expressed concern that Exon-Florio places no time limits on the President's authority to take action with respect to non-notified transactions. While the final regulations do not add a sunset provision as to the President's authority, they do limit "to three years the time during which an agency can give notice with respect to a completed transaction."[23] "After the three year period, only transactions that appear to raise national security concerns can be reviewed and investigated, pursuant to a request from the Chairman of [CFIUS] in consultation with other members"[24] of the Committee.

Any comfort a party to an acquisition feels because of its decision to file voluntary notice under Exon-Florio must be tempered by the requirement that such notice not contain any "material" omission of fact. For example, one regulation provides for renewal of an investigation and other consequences where CFIUS determines that a filing

19. *Id.* at 58776.
20. *Id.* at 58777.
21. *Id.*
22. *Id.*
23. *Id.* at 58774; 31 C.F.R. § 800.401(c) (___).
24. 56 Fed. Reg. at 58777. The final regulations emphasize that § 800.401 does not affect the president's powers under Exon-Florio. *Id.* at 58779.

"omitted material information."[25] In addition, the regulation requires parties to supplement their filings with "any changes in plans or information."[26] Moreover, the preamble to the final regulations makes clear that "[a] material change that occurs during the course of a review that is not brought to [CFIUS'] attention will be subsequently viewed as an omission, and may cause [CFIUS] to reopen its consideration of a case."[27] The preamble adds that "[t]he same would be true of a change that occurs after the President has announced [a] decision but was contemplated by the parties at the time the transaction was under review and not communicated to [CFIUS]."[28]

Several commenters on the proposed regulations objected to the absence of any clear definition of the term "material," and specifically asserted that this omission created "uncertainty about the finality of any decision by the President not to investigate or take other action with respect to a notified transaction."[29] While the final regulations do not completely remedy this problem, the preamble does state that CFIUS generally would not find information to be "material" if it concerned "purely commercial matters having no bearing on national security, such as the price of stock."[30]

Some commenters further suggested that the final regulations incorporate a limit on the President's authority to re-open consideration of a transaction previously considered under Exon-Florio due to a material omission. CFIUS refused, reasoning that it could "potentially reward parties who conceal information or fail to take adequate care to bring all material facts about a transaction to light in a notice."[31] However, CFIUS' policy is not to reopen the review of an acquisition because of a material change that was "both conceived and executed after the President's determination as a basis for reopening a case."[32]

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25. 31 C.F.R. § 800.601(e) (____).
26. 31 C.F.R. § 800.701(a) (____).
27. 56 Fed. Reg. at 58777. A material omission also could nullify the effect of written advice by CFIUS under 31 C.F.R. § 800.601(d) (____) that an acquisition was not subject to Exon-Florio.
28. *Id.*
29. *Id.*
30. *Id.* at 58780.
31. *Id.* at 58777. Other commenters suggested a time limit on CFIUS ability to reject a notice on the grounds of material change. CFIUS rejected this because it "could prevent [CFIUS] from declining to complete its review of a transaction that changes radically very late in the 30-day review period, and could force an investigation even in a case where it would not otherwise be necessary." *Id.*
32. *Id.*

III. DEFINING "NATIONAL SECURITY" FOR EXON-FLORIO PURPOSES

Neither the Exon-Florio provision, nor the final regulations define the term "national security." This lack of a definition is largely due to Congress' desire — as evidenced by the legislative history of Exon-Florio — to construe the term broadly. However, CFIUS is not authorized to focus on more general questions about the possible effects of an acquisition of a U.S. firm by a foreign entity on the U.S. industry's commercial competitiveness in an international market.

The preamble to the final regulations reveals that CFIUS rejected several requests "for expanded guidance as to the meaning of the term 'national security.'"[33] Some commenters specifically suggested that changes be made in the regulations to incorporate either 1) *positive* lists of products and services considered essential to the national security, or 2) *negative* lists of products and services considered not essential to national security.[34] Other commenters suggested that the final regulations incorporate a multi-factor test, based on a list of products and services and secondary parameters such as the dollar value of the transaction, or the availability of the product or service from other U.S. suppliers.[35] CFIUS rejected these proposals on the ground that "they could improperly curtail the President's broad authority to protect the national security, and, at the same time, not result in guidance sufficiently detailed to be helpful to parties."[36]

Several commenters to the proposed regulations also suggested various "bright-line" tests to eliminate certain transactions from coverage, primarily based on transaction size.[37] For example, many commenters recommended that "transactions under a certain dollar threshold be exempted, on the theory that very small acquisitions could not possibly have a meaningful impact on the national security."[38] "Other parties suggested a test based on the market share represented by a particular transaction."[39] CFIUS rejected adopting any bright-line test for determining whether a transaction qualifies under the law because its "experience in reviewing notified transactions ha[d] demonstrated that there is no predictable relationship between the size or dollar value of a transaction and its significance to the national security."[40]

33. *Id.* at 58775.
34. *Id.*
35. *Id.*
36. *Id.*
37. *Id.*
38. *Id.*
39. *Id.*
40. *Id.*

Nevertheless, the preamble to the final regulations does provide limited guidance regarding factors considered by CFIUS in a national security analysis. While such guidance does not "have the legal effect of exemptions or lists," it does help give CFIUS' "general views as to when filing might be considered appropriate."[41] The preamble makes clear that voluntary notification "would clearly be appropriate when, for example, a company is being acquired that provides products or key technologies essential to U.S. defense requirements."[42] By contrast, notice should not be submitted "in cases where the entire output of a company to be acquired consists of products and/or services that clearly have no particular relationship to national security."[43]

Additionally, while there is no precise definition of "national security" for purposes of applying Exon-Florio, the legislative history of the provision, statements by CFIUS staff members to Congress and the public, and a review of the acquisitions which CFIUS has chosen to investigate together provide a workable definition. This composite reveals that the national security interest sought to be protected by Exon-Florio is grounded in the traditional U.S. policy of ensuring that 1) reliable sources of state-of-the-art goods and technology necessary for national defense continue to exist for the U.S. military, and 2) such goods and technology not be transferred to other governments in violation of U.S. export control laws.

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41. *Id.*

42. *Id.*

43. *Id.* CFIUS rejected other suggestions intended to "enhance public understanding of 'national security.'" For example, it refuses to issue binding advisory opinions "with respect to transactions on the strength of something less than full notice" because it "would be impossible for [CFIUS] to fulfill its obligation to make a thorough national security analysis based on an abbreviated or informal filing, and [CFIUS] in such cases would generally have to advise the parties to submit a formal filing resulting in lost time on both sides." *Id.*

CFIUS also refuses to publish "in summary form a digest of all the reviews and investigations [CFIUS] ha[s] undertaken, including information on how [CFIUS] disposed of each transaction." *Id.* CFIUS' reasons are two-fold. The first reason stems from CFIUS' belief that "national security considerations preclude revealing why [CFIUS] or the President reached a particular view." Without that information, "parties could inappropriately conclude that an outcome in a previous case would be relevant to the outcome of their own case where both appeared to involve similar facts and circumstances." *Id.* Thus, "[t]he public would have no way of assessing which factors were most important to [CFIUS'] final determination, or whether other factors, not mentioned in the summary, played an important role in the outcome." *Id.*

According to CFIUS, the second problem with publishing the outcome of CFIUS reviews and investigations results from CFIUS's statutory obligation to maintain the confidentiality of all filings. The preamble to the final regulations explained that "[P]ublication of even 'cleansed' summaries could sacrifice the confidentiality of a filing and potentially create concerns by the parties over inadvertent publication of business confidential information, while affording relatively little useful information to readers."*Id.*

Last years' "Operation Desert Storm" in the Persian Gulf clearly illustrated that U.S. defense strategy relies heavily on advanced technology. This technology is needed to produce weapons and related systems that U.S. authorities deem vital to national defense. Exon-Florio was designed to protect the U.S. military from the threat that an acquisition of a U.S. firm by a foreign entity would adversely affect the supply of such technology. For example, national security might be threatened if a foreign firm acquired the only reliable U.S. source for a certain type of technology research or component part and decided to terminate or reduce significantly the research or the production of the part. Note, however, that in making their determination whether the acquisition should be challenged, CFIUS and the President would likely consider the reliability of foreign sources for the technology research or component part.

It is important to point out that CFIUS does not limit its full-scale investigations to foreign acquisitions of U.S. firms which are completely or substantially dedicated to supplying goods or technology through direct contracts with the Defense Department. Indeed, this type of acquisition may likely be prevented independent of Exon-Florio as the result of other laws which impose restrictions on receipt of classified defense information by foreign entities. CFIUS recognizes that Exon-Florio's primary concern was that such other laws were insufficient to protect against loss of a reliable source for important technology research and goods that might result from the foreign acquisition of a U.S. firm. For example, foreign acquisition of a U.S. firm engaged in the development of important technology and component parts with both military and civilian applications — such as semiconductors — which the firm indirectly supplied to the U.S. military through transfers of technology or sales of component parts to companies, which in turn had direct contracts with the Defense Department, could potentially threaten national security. As one report to Congress recognized, the "national security" threat which prompted Exon-Florio's enactment was that the U.S. defense industrial base "is being gradually 'hollowed out' as foreign investment takes place, not necessarily in plants directly producing defense systems, but in the lower tiers of component suppliers producing goods with both military and civilian applications."[44]

44. Report to the Chairman, Subcommittee on Oversight and Investigations, Committee on Energy and Commerce, House of Representatives, *Foreign Investment: Analyzing National Security Concerns* (General Accounting Office, March 1990), at 9.

Thus, one of CFIUS' primary objectives in reviewing a particular acquisition is to learn the nature of the U.S. firm's relationship to defense-related work. CFIUS also investigates the new owner's plans for the U.S. firm by questioning it about its intention to: 1) continue production, research and development in the U.S., 2) pursue particular product lines, 3) continue supplying the Defense Department (either directly or indirectly), and 4) close or relocate U.S. plants.

IV. Definition of "Foreign Person"

The final regulations define "foreign person" as "[a]ny foreign national" or "[a]ny entity over which control is exercised or exercisable by a foreign interest."[45] This definition modified the former definition of "foreign person" to clarify that "there must be the present potential for control by a foreign interest, rather than a mere remote possibility, for an entity to be considered a foreign person" under the law.[46] "Whereas the regulation previously read 'an entity over which control is *or could be exercised* by a foreign interest,' the *italized* phrase has been replaced by 'exercised or exercisable' to alleviate vagueness or remoteness in the standard."[47] Thus, "only the present potential for control (regardless of whether the foreign interest actually exercises it)" matters.[48]

V. Meaning of Foreign "Control"

As a threshold matter, an acquisition is subject to a "national security" review under Exon-Florio only where a foreign entity could exercise "control" over a U.S. business. The new regulation specifically defines "control" to mean:

> the power, direct or indirect, whether or not exercised, and whether or not exercised or exercisable through the ownership of a majority or a dominant minority of the total outstanding voting securities of an issuer, or by proxy voting, contractual arrangements or other means, to determine, direct or decide matters affecting an entity.[49]

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45. 31 C.F.R. § 800.211 (___).

46. *Id.*; 56 Fed. Reg. at 58778.

47. *Id.*

48. *Id.*

49. 31 C.F.R. § 800.204(a) (___). By way of example, and without limitation, § 800.204(a) states that "control" means the authority to "determine, direct, take, reach or cause decisions regarding: (1) The sale, lease, mortgage, pledge or other transfer of any or all of the principal assets of the entity, whether or not in the ordinary course of business; (2) The dissolution of

The proposed regulations defined control "functionally, in terms of the ability of the acquirer to make certain important decisions about the acquired company, such as whether to dissolve the entity, or to relocate or close production or research and development facilities."[50] Several commenters on the proposed regulations complained that this standard was "too nebulous," and advocated a bright-line test for control based on a particular percentage of stock ownership and/or the composition of the board of directors. CFIUS rejected this recommendation, reasoning that such bright-line tests were inconsistent with "the national security purposes" underlying Exon-Florio.

Nevertheless, CFIUS did "make certain minor adjustments in the control standard to remove unnecessary ambiguity."[51] For example, the proposed regulations included in the definition of control, the ability to "formulate" matters or decisions affecting an entity. The final regulations omit this term because several commenters were concerned the ability to "formulate" is "not a meaningful index of control, since technically any shareholder has this right."[52]

The definition of control also was modified to "clarify that a U.S. person will not automatically be deemed to be foreign-controlled where a number of unrelated foreign parties hold an interest in that person."[53] This definition would apply "even when the foreign parties taken as a whole hold the majority of stock in a U.S. company."[54] Foreign control will only be found if it is determined that "any single foreign party, acting on its own or in concert with another party [e.g., through contractual arrangements], could control the U.S. person."[55]

VI. DEFINITION OF "U.S. PERSON"

The final regulations define "U.S. person" as any entity "but only to the extent of its business activities in interstate commerce in the United States, irrespective of the nationality of the individuals or entities which control it."[56] The final regulations also include a third

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the entity; (3) The closing and/or relocation of the production or research and development facilities of the entity; (4) The termination or non-fulfillment of contracts of the entity; or (5) The amendment of the Articles of Incorporation or constituent agreement of the entity with respect to the matters described at paragraph (a)(1) through (4) of this section." *Id.*

50. 56 Fed. Reg. 58776.

51. *Id.*

52. *Id.* at 58778.

53. *Id.; see* 31 C.F.R. § 800.204(b) (___); 56 Fed. Reg. at 58778.

54. 56 Fed. Reg. at 58778.

55. *Id.*

56. 31 C.F.R. § 800.220 (___).

example "[t]o underscore the significance of [the above-quoted] qualifier to the definition . . . ."[57] The example describes the acquisition of a foreign subsidiary of a U.S. corporation by a foreign person. In the example, the foreign subsidiary has no fixed place of business in the United States, but merely exports goods to the U.S. parent and to unaffiliated companies in the United States. As the preamble to the final regulations makes clear, "[t]he acquisition of such an entity by a foreign person would not constitute the acquisition of a U.S. person under [Exon-Florio because] the mere export of goods to the United States by a foreign subsidiary with no fixed place of business in this country does not constitute 'business activity in interstate commerce in the United States'" for purposes of Exon-Florio.[58]

VII. APPLICATION OF EXON-FLORIO TO JOINT VENTURES INVOLVING FOREIGN PERSONS

The final regulations attempt to clarify the application of Exon-Florio to joint venture transactions involving foreign participants. Specifically, a new provision states that Exon-Florio applies only to joint ventures "in which a United States person and a foreign person enter into contractual or other similar arrangements on the establishment of a new entity but only if a United States person contributes an *existing identifiable business* in the United States and a foreign interest would gain control over that existing business by means of the joint venture."[59] Thus, a joint venture "in which the U.S. contribution is a company founded for the purposes of the transaction would not be subject to" Exon-Florio.[60] "Moreover, even where an identifiable business has been contributed to the venture, the transaction is not subject to [Exon Florio] unless the foreign party would control the venture."[61] "Therefore, joint venture transactions in which control is equally shared by the U.S. partner and the foreign partner, *i.e.*, where each party has a veto power over all the decisions of the joint venture, would not be subject to" Exon-Florio.[62]

Significantly, the new regulation regarding joint ventures "does not apply to other forms of business organization, such as when a foreign person acquires fifty percent of the stock of an existing U.S.

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57. 56 Fed. Reg. at 58778.
58. *Id.*
59. 31 C.F.R. § 800.301(b)(5) (___) (emphasis added).
60. 56 Fed. Reg. at 58778.
61. *Id.* at 58778-79.
62. *Id.* at 58779.

company."[63] In such cases CFIUS, depending on other facts of the transaction, may "conclude that the stock acquisition confers control on the foreign person."[64]

VIII. Application of Exon-Florio to Loan Transactions Involving Foreign Lenders

The proposed regulations were "deliberately vague as to whether foreign lending transactions would be covered" under Exon-Florio, and, if covered, when the appropriate time for giving notice would be (i.e., at the time a loan was made or at the time of the default).[65] Most commenters urged that lending transactions not be covered at the time a loan is made because of the "unlikelihood that the loan itself [would] culminate in the foreign lender's acquiring control."[66] Commenters were also concerned that foreign lenders would worry that the value of their security interest in the domestic debtor's property could be subject to Exon-Florio.

The preamble to the final regulations specifies that Exon-Florio does not apply to a foreign lender's "acquisition of a security interest" in a U.S. business, as long as that foreign lender cannot exercise "control" over that business.[67] However, "if a lending transaction included . . . contractual or other arrangements that conferred control [on the foreign lender], the transaction would be subject to" Exon-Florio.[68] Significantly, however, the preamble emphasizes that "standard provisions of loan contracts (e.g., ordinary covenants of the borrower pertaining to liens, or a lender's right of veto over mergers or the sale of property), in and of themselves . . . [would not] confer control over the borrower."[69]

Under the final regulations, CFIUS will not even accept notice of a foreign lender's acquisition of a security interest if the acquisition does not result in control over the U.S. business.[70] Some commenters asserted that if CFIUS does not accept notification of a lending transaction until actual or imminent default by the borrower, the lender would "never have adequate assurance of the value of its security

63. *Id.*
64. *Id.*
65. *Id.* at 58776.
66. *Id.*
67. *Id.*
68. *Id.*
69. *Id.; see also* discussion regarding 31 C.F.R. § 800.302, *in* 56 Fed. Reg. at 58779.
70. 31 C.F.R. § 800.303(a)(1) (___).

interest," which could "discourage foreign lenders from entering into financing transactions that may be subject to" Exon-Florio.[71]

Additionally, CFIUS refused to exempt from Exon-Florio a foreign lender's "acquisition of stock or assets as a result of a default" by the borrower. However, in determining whether a foreign lender's relationship with a defaulting U.S. business amounted to control of that business, CFIUS agreed to consider "steps the lender [has taken] to transfer the day-to-day control over the U.S. person to U.S. nationals, pending final sale of the U.S. person."[72] Thus, CFIUS might "determine that the lender does not control a company acquired through default" if the lender appointed "a trustee to run the company and commit[ted] to sell it within a specified reasonable period of time."[73]

IX. Application of Exon-Florio to Proxy Contests

The final regulations also address a foreign entity's acquisition of a U.S. person by a proxy contest undertaken for the purpose of obtaining control, such as a contest to change the board of directors.[74] "Parties may give notice at or just prior to the time a proxy solicitation commences."[75] However, proxy contests "undertaken for any purpose other than to obtain control [are not] covered by the regulations."[76] While the proposed regulations left unresolved the issue of who are the parties to an acquisition in the case of a proxy solicitation, the final regulations make clear that "both the persons soliciting proxies as well as the person who issued the voting securities [are] parties to the acquisition."[77]

X. Application of Exon-Florio to Acquisition of Assets of a U.S. Business

The final regulations specify that Exon-Florio applies to the

71. 56 Fed. Reg. at 58779.

72. *Id.*

73. *Id.* In addition, 31 C.F.R. § 800.303(b) specifically provides that CFIUS will not deem a foreign bank participating in a loan syndication to have control for purposes of Exon-Florio if such lender needs the consent of the majority of the U.S. participants to take action, or does not have a lead role in the syndicate and is subject to a special provision limiting its influence, ownership or control over the borrower. This is "[i]n view of the limitations on control of the borrower by any one bank that are often inherent in the structure of a syndicate of banks in a loan participation . . . ." 56 Fed. Reg. at 58779.

74. 31 C.F.R. § 800.201(a) (___); 56 Fed. Reg. at 58778.

75. 56 Fed. Reg. at 58778.

76. *Id.*

77. *Id.*; 31 C.F.R. § 800.214(e) (___).

> acquisition of a business, including any acquisition of production or research and development facilities operated prior to the acquisition as part of a business, if there will likely be a substantial use of 1) the technology of that business, excluding technical information accompanying the sale of equipment, or 2) [P]ersonnel previously employed by that business.[78]

The preamble to the final regulations observes that under this language, Exon-Florio *does not apply to* the sale of equipment or assets unless the "technology acquired by the foreign person is separate and apart from that inherent in, or typically accompanying the asset, such as instruction manuals and operating procedures that would routinely accompany equipment."[79]

XI. Results of Full-Scale CFIUS Investigations under Exon-Florio

In February 1990, President Bush followed CFIUS' recommendation and ordered China National Aero-Technology Import and Export Corp. (CATIC), a company owned by the People's Republic of China, "to divest its interest" in MAMCO, Inc., a Seattle, Washington metal aircraft component manufacturer. A statement issued by the White House said that "based on credible confidential information, the President determined that CATIC's continued control of MAMCO might threaten to impair the national security," and that "no other provision of law provided [the President] with adequate and appropriate authority to protect the national security in this case."[80]

The parties had provided CFIUS with voluntary notice of the acquisition but had completed the acquisition prior to the end of CFIUS' thirty-day preliminary review. Under the President's order, CATIC was given three months to divest its interest in MAMCO. Following the President's decision, a Treasury Department official referred to the MAMCO transaction as "an unusual and extraordinary circumstance" and emphasized that the divestiture was not made on foreign policy grounds, but rather on a judgment based on the past behavior of CATIC.[81] By contrast, parties to the acquisition acknowledged that MAMCO had certain technology subject to U.S. export controls, but felt that this fact was insignificant because CATIC had export licenses for other business ventures in the U.S.

78. 31 C.F.R. § 800.201(b) (___).

79. 56 Fed. Reg. at 58778.

80. 7 Int'l Trade Rep. (BNA) 178 (Feb. 7, 1990).

81. 7 Int'l Trade Rep. (BNA) 273 (Feb. 21, 1990).

Three previous CFIUS investigations of proposed foreign acquisitions of U.S. companies resulted in decisions by President Bush not to intervene in the transactions. The first investigation by CFIUS involved an agreement by Huels AG, a German company, to acquire Monsanto Electronic Materials Co., a U.S. maker of silicon wafers. Twenty-nine members of Congress wrote to President Bush, urging him to block the transaction on the ground that it would have "severe national security and economic implications."[82] The members noted that Monsanto was "the last major domestic manufacturer of silicon wafers," and that many of the leading computer chip manufacturers in the U.S. are dependent upon outside supplies of silicon wafers.[83] They added that "[w]ithout a reliable domestic source, their ability to remain competitive in the semiconductor industry may be severely affected."[84] They also noted that the U.S. market share of wafer sales was only fourteen percent and "threaten[ed] to plummet to two percent should this sale be finalized."[85] They added that "the virtual sell-off of the wafer industry will help seal the fate of our weakening high technology infrastructure."[86] Despite this plea, on February 7, 1989, the White House announced that President Bush had accepted CFIUS' recommendation and would not block the transaction.[87]

CFIUS also investigated, but did not recommend disturbing, a joint venture with a buyout option between the Swedish-Swiss firm, ABB Asea Brown Boveri, Ltd. and Westinghouse Electric Corp.[88] CFIUS took the same action regarding an acquisition by the French company Matra, SA of three divisions of Fairchild Industries engaged in space and defense electronics technology.[89]

In April 1990, several members of Congress, including those representing the State of Massachusetts, sent a letter to President Bush urging him to initiate an investigation into the national security aspects of a hostile takeover bid for the Worcester, Massachusetts-based Norton Co. by a U.K. company, BTR, PLC.[90] The hostile bid was actually made by ER Holdings Inc., a Delaware corporation which is a wholly-

82. 6 Int'l Trade Rep. (BNA) 152 (Feb. 1, 1989).
83. *Id.* at 183.
84. *Id.*
85. *Id.*
86. *Id.*
87. *Id.* at 182.
88. 6 Int'l Trade Rep. (BNA) 664 (May 24, 1989).
89. 6 Int'l Trade Rep. (BNA) 1096 (Aug. 23, 1989).
90. 7 Int'l Trade Rep. (BNA) 604 (Apr. 25, 1990).

owned subsidiary of BTR. The members asserted that Norton is "at the leading edge in the development of technology critical to the future of U.S. weaponry and advanced electronics."[91] At the time several of Norton's products were being sold to the Defense Department, including radomes, missile domes, advanced ceramic high-technology bearings, and ceramic aircraft engine parts.[92] Norton was also engaged in extensive research and development of advanced ceramics and diamond films.

In June 1990, President Bush decided not to intervene in the possible acquisition of Norton by BTR.[93] However, during the CFIUS investigation, Norton had agreed to a friendly takeover offer from a French company, Cie. de Saint-Gobain. CFIUS staff members recommended that the BTR acquisition not be investigated but were overruled by more senior administration officials who called for the investigation due to Congressional pressure. After being informed of the French company's offer, CFIUS began investigating that transaction. President Bush decided in August 1990 not to intervene in the French acquisition.[94]

President Bush also determined, in May 1990, not to interfere with the possible acquisition by CMC, Ltd., a computer software and support company owned by the Indian government, of UniSoft Group, PLC, a London-based software consulting firm with a subsidiary in Emeryville, California.[95] UniSoft designs customized applications for Unix, a sophisticated computer program used for both commercial and military applications. UniSoft's services included the use of a digital encryption standard, a technique for encoding data that is subject to U.S. munitions controls. Although UniSoft had no classified contracts with the U.S. Government at the time, it was supplying firms that incorporate UniSoft's services in manufacturing classified military products. The CFIUS investigation, requested by the Defense and Commerce Departments, was launched, in part, to determine whether UniSoft had sufficient controls to ensure that the encoding standard would not be exported. The President reportedly based his decision not to interfere on a unanimous recommendation from CFIUS.[96]

Another investigation involved the proposed sale to Nippon Sanso, a Japanese company, of Hercules Inc.'s Semi-Gas Systems unit based

91. *Id.*
92. *Id.*
93. 7 Int'l Trade Rep. (BNA) 1006 (July 4, 1990).
94. 7 Int'l Trade Rep. (BNA) 1270 (Aug. 15, 1990).
95. 7 Int'l Trade Rep. (BNA) 664 (May 9, 1990).
96. *Id.*

in San Jose, California.[97] Semi-Gas makes delivery systems for gases used in manufacturing semiconductor chips, and reportedly controls some forty percent of the U.S. market for such gases.[98] Nippon Sanso is Japan's largest supplier of industrial gases, and it ranks among the world's top five suppliers of such gases.[99]

One of Semi-Gas's customers is SEMATECH, an Austin, Texas-based cooperative effort between the Defense Department's Advanced Research Projects Agency and major U.S. semiconductor chip makers. SEMATECH is an effort to help the U.S. semiconductor industry regain a position of world leadership.[100] In July 1990, President Bush adopted CFIUS' recommendation not to block the sale.[101] CFIUS' investigation focused on two major points: 1) protection of proprietary SEMATECH information, and 2) the importance of Semi-Gas technology. Apparently, Nippon Sanso made good faith representations that it would enter into a confidentiality agreement with SEMATECH.

CFIUS also investigated a proposed acquisition by Fanuc Ltd., a Japanese company, of a minority stake in Moore Special Tool Co. of Bridgeport, Connecticut. Moore supplies the U.S. Energy Department with precision machine tools used in making nuclear weapons.[102] Fanuc eventually withdrew its purchase offer.[103]

In two other cases, proposed transactions were withdrawn before completion of the 45-day investigation period. One involved a bid by India's Lalbhai Group to purchase Tachonics Corp., a unit of Grumman Corp. that makes computer chips used in military applications.[104] The other transaction was an offer by Japan's Tokuyama Soda Co. to acquire General Ceramics, Inc., a New Jersey firm that had a classified contract with the Energy Department.[105] Tokuyama and General Ceramics withdrew their notification to CFIUS before the forty-five day investigation period ended, and they restructured the transaction by, in part, General Ceramics assigning its classified contract and the sale of its contract-related assets to a third party.[106] The companies

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97. 7 Int'l Trade Rep. (BNA) 1197 (Aug. 1, 1990).
98. *Id.*
99. *Id.*
100. *Id.*
101. *Id.*
102. 7 Int'l Trade Rep. (BNA) 1739 (Nov. 14, 1990).
103. 8 Int'l Trade Rep. (BNA) 321 (Feb. 27, 1991).
104. 7 Int'l Trade Rep. (BNA) 178 (Feb. 7, 1990).
105. *Id.*
106. *Id.*

then notified CFIUS of their restructured transactions, and CFIUS found no national security threat.[107]

While a review of all the instances in which CFIUS has decided not to conduct a full-scale investigation is well beyond the scope of this article and perhaps impossible given the confidentiality of CFIUS' deliberations, several publicized decisions may be of interest. In March 1989, CFIUS chose not to proceed with a full-scale investigation of an attempt by Minorco, S.A. — a Luxembourg investment company controlled by Anglo American Corporation of South Africa Limited, and De Beers Consolidated Mines Limited, which in turn are controlled by South Africa's Oppenheimer family — to acquire Consolidated Gold Fields PLC. Consolidated is a British company which at that time owned nearly fifty percent of Newmont Mining Corporation, a leading United States gold producer. In March 1989, CFIUS concluded the sale would not pose a threat to U.S. national security.[108] According to a Treasury Department official, this conclusion resulted from "an extensive investigation of the potential threat to the national security through Minorco's increased control of strategic minerals."[109] The Treasury official stated that in reaching its decision, CFIUS relied on "data and expertise" from the United States Bureau of Mines, and "assumed the worst case scenario of a total cut-off of supply of the strategic mineral assets by Minorco and other companies with South African connections."[110] CFIUS concluded that even in such a situation, the United States' strategic stockpiles, production capability and existing inventories of selected strategic minerals would be sufficient to meet its strategic needs. CFIUS specifically concluded that even a total interruption of supplies of rutile, zircon, zirconium, monazite, platinum, and gold would not threaten national security.[111]

In early 1989, a Treasury Department official informed Congress of CFIUS' determination that Saudi Arabia's proposed acquisition of a fifty percent interest in certain Texaco, Inc. operations did not warrant a full-scale Exon-Florio investigation. The transaction in question specifically involved the purchase by a Saudi government-owned company of a fifty percent stake in a joint venture to own and operate certain Texaco refining and distribution assets in twenty-three eastern and southeastern states. The assets included three major refineries,

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107. *Id.*
108. 6 Int'l Trade Rep. (BNA) 396 (Mar. 29, 1989).
109. *Id.*
110. *Id.*
111. *Id.*

forty-nine terminals, 1,450 owned and leased service stations, and more than 10,000 franchised stations.[112]

XII. CONCLUSION

Exon-Florio "national security" review of foreign acquisitions of United States companies is a reality today and one that parties to such transactions must consider. As the Chinese company CATIC learned the hard way, CFIUS may recommend, and the President may order the divestiture of an acquisition subject to Exon-Florio. Required divestiture can occur even if the transaction is completed and if the parties did not notify CFIUS of the transaction. Foreign parties contemplating acquisitions and other investment opportunities in the United States must keep in mind the final regulations, and the national security concerns which led to Exon-Florio, as they make and implement their business plans.

112. 6 Int'l Trade Rep. (BNA) 152 (Feb. 1, 1989).