

F O R T R E S S A M E R I C A ?

# Fortress America?

National Security Restrictions  
on Foreign Acquisitions  
in the United States

May 24, 2006

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## National Security Reviews: Meeting the Legal Requirements

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# F O R T R E S S A M E R I C A ?

## The Exon-Florio Process

- Voluntary Notification
- Consideration by CFIUS
- 30/45/15-Day Stages of Review, Investigation, Presidential Decision
- Under Two Percent of Notifications Are Subject to Investigation Stage
- Frequent Manipulation of Deadlines Through Withdrawal and Resubmission of Notifications

# F O R T R E S S A M E R I C A ?

## The Traditional National Security Criteria

- No Statutory Definition of “National Security”
- Statutory “Factors” That CFIUS “May” Consider Focus on Military Production and Preparedness
- CFIUS Regulations Focus on Whether U.S. Target Makes Goods and Technologies With Defense or Military End-Uses and Whether It Supplies the Defense Department or Military Branches
- CFIUS Regulations Also Focus on Whether Foreign Acquirer Plans to Move Production Offshore

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## The New National Security Criteria

- Without Change in Statute or Regulations, CFIUS Nevertheless Has Expanded The Scope of Its National Security Scrutiny
- Acquisitions in Industry Sectors Important to Homeland Security — Telecommunications, Infrastructure, Energy — Are Now More Difficult
- National Security Credentials of Acquirer Are More Carefully Examined

## National Industrial Security Program Safeguards

- Increasingly, Safeguards That Had Been Required Only Under NISP (for Targets with Classified Facilities) Are Being Demanded Generally in Acquisitions with National Security Implications
- Separate Boards of Directors Consisting of U.S. Citizens, Approved Board Members and Management, and Security Agreements Are Among Structural Safeguards That Insulate Foreign Acquirer from Sensitive U.S. Operations

# F O R T R E S S A M E R I C A ?

## Mastering the New Approach

- Broader Consideration of the Appropriateness of Filing an Exon-Florio Notification
- Anticipation of More Searching and More Prolonged CFIUS Examinations
- Anticipation of More Political Pressures
- Pre-Filing Consultations with CFIUS
- Earlier Introduction of Security Safeguards

# F O R T R E S S A M E R I C A ?

## DOD, The NISPOM and Review of Defense Transactions

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# FOR TR E S S A M E R I C A ?

## NISP

- **The National Industrial Security Program (NISP) establishes a government-wide program to protect classified information and “preserve U.S. economic and technological interests.”**
- **Key consideration in determining whether a potential threat to national security exists is whether the acquired company (or assets) are involved in performance of U.S. Government contracts.**
  - **Must examine whether the acquired entity is involved in the U.S. defense infrastructure.**
  - **As a prime or subcontractor.**

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## NISP

- DOD responsible for NISPOM—procedures for release of classified information to industry and granting/maintaining security clearances.
  - Applied government-wide.
- Responsibility for information to be classified is up to the “Cognizant Security Agencies” (“CSA”).
  - Includes DOD, DOE, CIA, NRC.

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## NISPOM

- NISPOM linchpin concept: no classified information may be disclosed to any contractor (or subcontractor) unless the company's facility has received a Facility Security Clearance ("FSC") at the level of information to be accessed.
  - FSC only available to companies organized and existing in the U.S.
  - Subsidiary generally cannot obtain FSC unless parent has FSC at same level.

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## NISPOM

- Security clearance decision is highly discretionary.
- Security clearances may not be granted to facility that is determined to be under Foreign Ownership Control or Influence (“FOCI”).

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## FOCI

- FOCI exists whenever a foreign interest has the power, directly or indirectly through ownership, contract or other means to direct or decide matters affecting management or operations of U.S. company in a manner that “may” result in unauthorized access to classified information or adversely affect performance of classified contracts.

### Relevant factors to FOCI determination:

- Extent of foreign stock ownership.
- Extent to which foreign interests control or influence directors, officers or executives.
- Extent of agreements with or indebtedness to foreign interests.
- Interlocking directors with foreign interest.

## FOCI Mitigation

- NISPOM permits FOCI to be mitigated to allow companies to obtain or perform classified U.S. Government contracts under certain circumstances.
- Reciprocal security agreement with foreign government: access is on a case-by-case basis and usually only for joint programs.
- Voting trust or proxy agreement: isolates foreign owner from all operations and limits participation to major events such as sale, merger or bankruptcy.

## FOCI Mitigation

- Special Security Agreement (“SSA”): 3-way agreement between U.S. company, foreign owner and DOD that sets up a special board and permits some participation by foreign owner in management and business decisions not involving classified information or contracts.
  - Company under FOCI can only be cleared at secret level.
    - May NOT have access to sensitive information without a National Interest Determination (“NID”) from the U.S. buying agency. Agreement includes provisions regarding “controlled unclassified information” subject to U.S. export control laws.

## FOCI Mitigation

- Board exclusion resolutions may be used in some cases where FOCI can be mitigated by isolating a person.
  - Growing issue for many U.S. technology companies with foreign born managers and executives.
- When DOD contractor, technology or information is involved, DOD will control the CFIUS determination.
  - If DOD is concerned about security of classified/controlled information, it will not permit FOCI mitigation measures acceptable to foreign buyer to be used

## Relationship To CFIUS

- Mandatory CFIUS investigation where foreign government controlled entity (or entity acting on behalf of foreign government) seeks to acquire U.S. company that could affect national security.
  - Potential transfer of technology to terrorist states.
  - Impact on U.S. technological leadership.
  - What constitutes foreign government control not clearly defined.

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## Relationship To CFIUS

- No foreign controlled government entity may purchase a U.S. defense contractor unless a complete CFIUS review is performed.
- Critical Infrastructure acquisitions do not trigger automatic review. *But see* Network Security Agreement in the case of Global Crossing.

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## DOD/DHS Overlap

- No bright line separating technology and services used in the national defense by DOD and DOE, and those used for homeland security by DHS.
  - Defense technology (and contractors) being used, refined, developed for homeland security purposes.
  - Information shared between departments, e.g., DOD, Coast Guard, TSA.
  - Research conducted by DARPA and HSARPA.
  - Research at national laboratories.

# F O R T R E S S A M E R I C A ?

## TRENDS

- Acquisition of core technology, such as semiconductors, information technology, and telecommunications (including Internet technology) received heightened scrutiny.
- Regulations focus on transfer of military technology and dual use technology.
- U.S. Government departments and agencies classifying more work-especially services work. Huge demand for security clearances for companies supplying services to Government.
- Agencies restricting access to Sensitive But Unclassified Information (“SBU”) by contract.

# F O R T R E S S A M E R I C A ?

## TRENDS

- Department of Homeland Security (“DHS”) recently received a seat on CFIUS.
- DHS acquisition regulations restrict dramatically companies with foreign employees.
- DHS regulations require strict personnel clauses.
  - Non-U.S. citizens prohibited from performing any work on IT contracts without a waiver.

## Noteworthy Transactions

- 2006: Dubai Ports World/Peninsular and Oriental Steam Navigation Company.
    - DPW to turn over ports to U.S. entity.
  - 2005: China National Offshore Oil Corporation/Unocal.
    - Political and popular uproar ended deal before parties requested CFIUS review.
  - 2005: BAE/United Defense, L.P.
    - Approved, longstanding special security agreement in place
  - 2003: ST Telemedia/Global Crossing.
    - Approved, with network security agreement in place covering physical, logical, information and personal security, overseen by a board security committee.
  - 2000: BAE/Sanders.
    - Approved, special security agreement in place.
  - 2000: Nippon Telephone & Telegraph Company/Verio, Inc.
    - Approved, with strict ban on Japanese government involvement in internet service provider firm.
- \* \* \*
- 1990: China National Aero-Technology Import and Export Corporation/Mamco Manufacturing Company.
    - Only transaction ever prohibited by the President.

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## CONCLUSION

- National security: may be viewed much more broadly than acquisitions of “pure” defense technology. Exon-Florio and NISP permit an expanded view. Agencies are adding restrictions by procurement regulation and contract.

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## Overcoming the Political Hurdles: Strategy and Tactics

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# F O R T R E S S A M E R I C A ?

## CFIUS Decision-Making Post Dubai Ports

- ❑ Primary Concern is National Security
- ❑ Extreme Caution
- ❑ Procedural Changes
- ❑ Political Influence

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## Key Decision Makers

- CFIUS Members
- White House
- Congress

# F O R T R E S S A M E R I C A ?

## CFIUS Members

- Treasury (Chair)
- Defense
- State
- Commerce
- Justice
- Homeland Security
- National Security Council
- USTR
- National Economic Council
- Council of Economic Advisors
- Office of Management & Budget
- Office of Science & Technology

# F O R T R E S S A M E R I C A ?

## Strategy for Success

- Meet with Key CFIUS Members
- Build Support with Key Members of Congress
- Anticipate and Prepare for Opposition
- Develop Public Relations Strategy

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## Tailor Your Message

- Treasury: Business Case; Positive Impact of Foreign Investment (Jobs); Stress Details
- Defense: National Security; U.S. Industrial Base; Technology
- State: NonProliferation; Bilateral Relations
- Commerce: Export Controls; Industrial Base; Jobs
- DOJ: Technology; Homeland Security
- DHS: Internal Security Issues; Technology

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## Summary – Keys to Success

- Be Prepared to Explain and Justify Your Transaction
- Be Prepared to Accept Safeguards or Define What You Cannot Accept
- Be Prepared to Campaign

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## Congressional Update: Likely Amendments to Exon-Florio

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## Overview: Bills Introduced in the 109<sup>th</sup> Congress

- Numerous Bills Introduced in House and Senate
- Amendments to Reform the U.S. Foreign Investment Review Process *and* Change CFIUS
- Goals: Transparency, Accountability, Notification
- Leading Senate Bill – Shelby-Sarbanes Bill
- Leading House Bill – H.R. 5337 (Blunt Bill)
- Status and Potential Action

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## Goals

- Shift from Encouraging Foreign Investment to More Protection of National Security
- Extend Review/Investigation Timetables
- Impose Mandatory Investigations Under Certain Circumstances
- Improve Notification and Reporting Requirements By CFIUS to Congress
- Require Structural Changes to CFIUS

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## Leading Senate Bill: The Foreign Investment and National Security Act of 2006 (Shelby-Sarbanes Bill)

- 30-Day Review, With Possible Extension For Another 30 Days
- 45-Day Investigation Required If Transaction Involves Foreign Government or “CRITICAL INFRASTRUCTURE” *And* Presents Threat to National Security
- CFIUS Must Notify Congress of All New Reviews Within 10 Days of BEGINNING a Review
- CFIUS Must Notify Congress Upon Commencement of an Investigation and Upon Disposition of a Review/Investigation
- CFIUS: Chair = Secretary of the Treasury / Vice-Chair = Secretary of Defense
- Removes 5 Current CFIUS Members – Fewer Pro-business / Pro-technology Agencies
- Country Ranking List According to Potential Risk

## Leading House Bill: H.R. 5337 (Blunt Bill)

- 30 Day Review – No Extension
- Mandatory 45-Day Investigation for Transactions Involving Foreign Governments, With Possible 45-Day Extension If 2/3s of CFIUS Members Approve
- CFIUS Notification to Congress Within 5 Days at the End of Each 45-Day Investigation
- Semi-Annual Reporting to Congress on CFIUS Activities
- New Mitigation Agreement Monitoring
- CFIUS Chair = Secretary of Treasury / Vice-Chair = Secretary of Homeland Security
- Requires Signature of Chair & Vice-Chair on All Decisions
- No Country-Ranking System

## Status & Potential Action

### Congress

- Shelby-Sarbanes Bill – Unanimous Vote on March 30, 2006 by Senate Banking Committee; Moves to Senate Floor
- H.R. 5337 – Introduced by House Majority Whip R. Blunt on May 10

### Business Groups

- Seek Fair & Objective Foreign Investment Review Process
- Concerns: Additional Delays, Politicized Process, Disclosure of Confidential Information, Discouraging Foreign Investment

### Administration

- Committed to Moving Forward on Reform But Concern Over Relations With U.S. Allies, Delayed Decisions and Deterring Foreign Investment

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## Q&A