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Joanna Rubin Travalini

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# Foreign Direct Investment in the United States: Achieving a Balance Between National Economy Benefits and National Security Interests

*Joanna Rubin Travalini\**

## I. INTRODUCTION

Modern economies are dependent upon the resources and capital of foreign nations to remain competitive. The United States has long been a world leader in developing and encouraging open foreign investment policies aimed at enhancing the feasibility of cross-border deals and the advancement of domestic opportunities. With national security a primary concern of the U.S. government, balancing the interests of the national economy with those of national security has been a fundamental challenge. This challenge has only been heightened with the post-September 11 conception of national security needs.

This Note addresses the transformation of foreign direct investment in the United States in light of heightened national security standards since the September 11, 2001 attacks and highlights the treatment of three cross-border deals that made U.S. government officials question the thoroughness of foreign investment review policies. Despite the enactment of stricter guidelines in the review of foreign investment transactions, Congress must reexamine the extent of its influence in the process to ensure the retention of open and consistent foreign investment policies in the United States while preserving the best interests of those within its borders.

In Section II, this Note discusses the history of globalization and foreign direct investment, their development as staples of the U.S. economy, and the perceived advantages and disadvantages of global trade liberalization on the U.S. economy and national security standards. Section III provides an overview of the history and development of foreign direct

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\* Joint Juris Doctorate & Masters in Business Administration Candidate, 2009, Northwestern University School of Law & Kellogg School of Management.

investment in the United States and the various means of regulation that have been imposed in attempts to monitor cross-border transactions. Section IV discusses recent landmark cross-border deals that have shaped the current state of U.S. foreign investment law. Section V suggests the possible implications of current law on the future of foreign investment and trade in the United States. Finally, Section VI provides recommendations to improve foreign direct investment controls in the United States in order to maximize domestic economic benefits while minimizing national security risks.

## II. GLOBALIZATION, FOREIGN INVESTMENT, AND THEIR IMPACT ON THE UNITED STATES

Globalization provides individual national economies the means to create economic webs with other countries through the integration of markets and the unification of transportation and communication systems.<sup>1</sup> This process has effects on culture, political systems, economic development, and prosperity in societies around the world. Though globalization and cross-border trade are not new and have in fact been prevalent characteristics of functional societies for thousands of years, the development of technology and social policies has increased the magnitude and breadth of foreign trade and investment, causing new economies to be opened both domestically and internationally by improved investments. Advances in technology have provided new methods for consumers and businesses alike to identify and measure economic trends and to pursue new economic opportunities. Similarly, governments have negotiated reductions in barriers to commerce, taking advantage of new opportunities in the global marketplace and promoting international industrial and financial business models.

Through its development as a societal norm, globalization has allowed many poor countries and their citizens to develop economically and to raise their standards of living. It has “enlarg[ed] the world economy, promot[ing] technological innovations, foster[ing] universal political participation, and enhanc[ing] international cooperation.”<sup>2</sup> Further, globalization has provided a means for diverting human capital into more high-skilled jobs, while simultaneously increasing global cooperation and access to global resources.

Recognizing these numerous benefits, the United States has

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<sup>1</sup> Joseph Mamounas, *Controlling Foreign Ownership of U.S. Strategic Assets: The Challenge of Maintaining National Security in a Globalized and Oil Dependent World*, 13 L. & BUS. REV. AM. 381, 382 (2007).

<sup>2</sup> *Id.* at 383 (quoting Arthur C. Helton & Dessie P. Zagorcheva, *Globalization, Terrorism, and the Movement of People*, 36 INT’L LAW. 91, 92 (2002)).

historically taken a liberal policy toward foreign direct investment.<sup>3</sup> President Reagan is credited with shaping U.S. policy by emphasizing the domestic benefits of foreign investment with three policy objectives: “(1) liberalization of barriers and the reduction of distortion of international investments abroad, (2) encouragement of a greater role for private foreign investment in the economic development of less-developed countries, and (3) maintenance of the maximum degree of foreign investment openness for the United States economy.”<sup>4</sup> This aggressive approach towards foreign direct investment increased the appeal of the United States to foreign investors, thereby “entic[ing] foreign capital to the United States by highlighting the benefits [the United States] provides to foreign investors.”<sup>5</sup> As a result, the United States has led the revolution toward globalization and the free movement of capital.<sup>6</sup> The resulting domestic benefits of foreign investment have been plentiful: foreign capital has rescued many ailing U.S. companies, real estate values have been heightened, the pool of venture capital has increased, and local economies have been improved.<sup>7</sup> Increased foreign investment adds to the gross domestic product, simultaneously increasing the demand for U.S. labor and increasing the domestic standard of living.<sup>8</sup>

Despite the advantages globalization and foreign investment offer, their potential harmful impact on the economy and potential threat to national security standards are two of the most prevalent and argued disadvantages. From an economic perspective, foreign direct investment increases the number of acquisitions by foreign investors, which serves to transfer assets to an individual or company that answers to a foreign government. Critics argue that this adds nothing to U.S. productive capacity at the expense of economic security since an increased portion of domestic assets is in foreign control.<sup>9</sup> Further, critics cite that increased foreign investment and globalization entice foreign governments to use political influence to their advantage, weakening U.S. economic and social

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<sup>3</sup> Foreign direct investment is defined as: “ownership or control, directly or indirectly, by one foreign person of ten per centum or more of the voting securities of an incorporated U.S. business enterprise or an equivalent in an unincorporated U.S. business enterprise, including a branch.” 15 C.F.R. § 806.15(a)(1) (1993).

<sup>4</sup> Terry R. Spencer & Christian B. Green, *Foreign Direct Investment in the U.S.: An Analysis of Its Potential Costs and Benefits and a Review of Legislative Tools Available to Shape Its Future Course*, 6 TRANSNAT’L LAW. 539, 543 (1993).

<sup>5</sup> Jonathan C. Stagg, *Scrutinizing Foreign Investment: How Much Congressional Involvement Is Too Much?*, 93 IOWA L. REV. 325, 329 (2007).

<sup>6</sup> *Id.* at 330.

<sup>7</sup> *Id.* at 331.

<sup>8</sup> Spencer & Green, *supra* note 4, at 556.

<sup>9</sup> *Id.* at 552.

structures.<sup>10</sup>

Foreign direct investment and globalization also impact national security. Increased trade and a more open, continuous flow of human capital increase opportunities for crime by facilitating the opportunity for unethical and illegal practices to operate in a fairly unregulated environment. In this sense, globalization has the potential to “facilitate terrorism and impede anti-terrorism efforts ‘by making the movement of people and funds much easier.’”<sup>11</sup>

Balancing the desire for trade liberalization with national security concerns has proven to be a challenge for many nations. In the United States, transactions threatening national security include those that “compromise the strength and independence of defense contractors, impact U.S. leadership in technological areas, or affect important and strategic natural resources.”<sup>12</sup> The prevalence of global economic considerations in almost all domestic operations necessitates the consideration of potential foreign investments in national security issues. Globalization increases the opportunities for malicious and illegitimate foreign investments as well as large mergers and acquisitions—“foreign ownership of an American corporation provides a presence for that parent corporation’s country in the United States.”<sup>13</sup> Foreign ownership is of particular concern to national security if the purchasing country’s interests are different from those of the United States. In order to limit the opportunities for malicious foreign investment, it is imperative for government controls to be in place to review transactions, maintain domestic safety, and ensure that the United States does not tolerate national security concerns as a tradeoff for enhanced domestic and global economic development.

### III. HISTORY OF FOREIGN DIRECT INVESTMENT AND ITS REGULATION IN THE UNITED STATES

The United States has enjoyed a long history of foreign investment, with foreign investors encouraged to participate in trade agreements with the United States since the Louisiana Purchase and widespread industrialization in the 1800s.<sup>14</sup> Foreign investment has played an important role in the development of the national economy, but foreign imports have historically been perceived as a threat to the U.S. economy. As cross-border trade became more of a staple in domestic economic

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<sup>10</sup> *Id.*

<sup>11</sup> Mamounas, *supra* note 1, at 384 (quoting Arthur C. Helton & Dessie P. Zagorcheva, *Globalization, Terrorism, and the Movement of People*, 36 INT’L LAW. 91, 93 (2002)).

<sup>12</sup> Stagg, *supra* note 5, at 332.

<sup>13</sup> Mamounas, *supra* note 1, at 384.

<sup>14</sup> Paul I. Djuricic, *The Exon-Florio Amendment: National Security Legislation Hampered by Political and Economic Forces*, 3 DEPAUL BUS. L.J. 179, 180 (1991).

transactions, trade acts were amended to include both economic protection and national security concerns. In the 1970s, largely due to the decreased value of the U.S. dollar in relation to foreign currencies, foreign investment in the United States increased. As a result, Congress passed the Foreign Investment Study Act of 1974 (Study Act), “requiring the Secretaries of Treasury and Commerce to conduct a comprehensive review of foreign investment in the United States.”<sup>15</sup> The Study Act, through its mandated review of U.S. foreign investment policy, led the government to conclude that “the United States did not maintain an adequate mechanism for monitoring foreign investments.”<sup>16</sup>

In 1975, as an extension of the Study Act and in response to congressional concern that there lacked a strong mechanism to execute comprehensive reviews, President Ford created the Committee on Foreign Investment in the United States (CFIUS). The CFIUS had “primary continuing responsibility within the Executive Branch for monitoring the impact of foreign investment in the United States . . . and for coordinating the implementation of United States Policy on such investment.”<sup>17</sup> At the time of its creation, the CFIUS did not have substantial authority to regulate or prohibit those foreign investments that raised national security concerns. The CFIUS’s only power was to monitor investments and request foreign governments to file preliminary reports regarding their foreign investment activities.<sup>18</sup> With even less control over private foreign investors, the CFIUS was often referred to as “one of Washington’s legions of interagency committees, as toothless and obscure as any.”<sup>19</sup> However, as foreign investment opportunities became more complex, the need to increase the responsibilities and standards of the CFIUS became of paramount concern.

#### A. The CFIUS, Exon-Florio, and the Review Process

Since its creation in 1975, membership of the CFIUS has expanded three times and it now comprises representatives of twelve U.S. government agencies and departments.<sup>20</sup> The Departments of the Treasury, Homeland Security, Commerce, and Justice usually take the most active roles in the CFIUS review process, with the staff of the Office of International

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<sup>15</sup> Deborah M. Mostaghel, *Dubai Ports World Under Exon-Florio: A Threat to National Security or a Tempest in a Seaport?*, 70 ALB. L. REV. 583, 588–89 (2007).

<sup>16</sup> Djurisc, *supra* note 14, at 182.

<sup>17</sup> Mostaghel, *supra* note 15, at 589.

<sup>18</sup> Djurisc, *supra* note 14, at 183.

<sup>19</sup> *Id.* (quoting Leah J. Nathans, *Meet Wall Street’s New Bugaboo: CFIUS*, BUS. WK., June 12, 1989, at 90).

<sup>20</sup> Mamounas, *supra* note 1, at 391.

Investment of the Department of the Treasury administering the review.<sup>21</sup> The Department of Defense, with its expertise in national security standards and concerns, has been a particularly influential member of the CFIUS, with the CFIUS often deferring to it when evaluating a proposed transaction's national security implications.<sup>22</sup>

The CFIUS is responsible for reviewing the national security implications of foreign investments in the United States, without a focus on political considerations. It seeks to carry out domestic investment policy through "reviews that protect national security while maintaining the credibility of [U.S.] open investment policy and preserving the confidence of foreign investors here and of U.S. investors abroad that they will not be subject to retaliatory discrimination."<sup>23</sup>

The CFIUS gets much of its authority through the Exon-Florio Act of 1988 (Exon-Florio), which was enacted in response to the attempted acquisition of Fairchild Semiconductor Corporation (a U.S. company) by the Fujitsu Corporation (a Japanese company).<sup>24</sup> The attempted acquisition was perceived by the U.S. government as an attempt by Japanese companies to "dominate the world semiconductor market" and as a threat to both U.S. companies in the semiconductor industry and national security.<sup>25</sup> Although Fujitsu's acquisition fell through, Congress recognized that there was no legislation in place permitting the President to block such transactions.<sup>26</sup> As a result, the Exon-Florio provision was enacted to allow the President or his designee to "make an investigation to determine the effects on national security of mergers, acquisitions, and takeovers proposed . . . by or with foreign persons which could result in foreign control of persons engaged in interstate commerce in the United States."<sup>27</sup> However, before the President can act, the CFIUS investigation "must establish that the 'foreign interest exercising control might take action that impairs the national security' and that no other provision of law could adequately address the threat."<sup>28</sup>

In carrying out its duties to monitor the impact of foreign investment

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<sup>21</sup> Ilene Knable Gotts, Leon B. Greenfield & Perry Lange, *Is Your Cross-Border Deal the Next National Security Lightning Rod?*, BUS. L. TODAY, July/Aug. 2007, at 31, 32.

<sup>22</sup> Stagg, *supra* note 5, at 341.

<sup>23</sup> Mamounas, *supra* note 1, at 392 (quoting the U.S. Treasury – Committee on Foreign Investments in the United States (CFIUS), <http://www.treas.gov/offices/international-affairs/cfius> (last visited Apr. 1, 2009)).

<sup>24</sup> Stagg, *supra* note 5, at 335.

<sup>25</sup> *Id.*

<sup>26</sup> *Id.*

<sup>27</sup> Mamounas, *supra* note 1, at 388–89 (quoting 50 U.S.C. app. § 2170(a)).

<sup>28</sup> Stagg, *supra* note 5, at 336 (quoting the U.S. Treasury—Committee on Foreign Investments in the United States (CFIUS), <http://www.treas.gov/offices/international-affairs/cfius> (last visited Apr. 1, 2009)).

on the United States, the CFIUS receives notices of proposed foreign acquisitions of U.S. companies, distributes the notices to CFIUS member agencies, and coordinates reviews of the proposed deals.<sup>29</sup> After receiving a notice of proposed acquisition, the CFIUS has thirty days to decide whether to conduct a review, a decision that is based on whether the proposed transaction adversely affects national security.<sup>30</sup> If the CFIUS determines during the thirty-day review that additional review is needed, it may initiate a forty-five-day review.<sup>31</sup> If such an investigation is conducted, a report must be presented to the President containing the CFIUS's views regarding whether "there is credible evidence . . . to believe that the foreign interest exercising control might take action that threatens to impair the national security."<sup>32</sup> Once the CFIUS report has reached the President, he has fifteen days to decide whether to (1) take no action; (2) order divestiture if the transaction is already completed; or (3) block the transaction.<sup>33</sup> To block the transaction, the President must find "(1) credible evidence that a transaction would impair national security and (2) no other provision of law [that] grants him authority to take steps to ameliorate [the potential national security] impact [of the transaction]."<sup>34</sup>

The CFIUS review process operates through a system of voluntary filings in which foreign entities interested in acquiring U.S. companies notify the CFIUS of their interest prior to the completion of the transaction.<sup>35</sup> The primary advantage of voluntarily submitting to review is that the foreign company can obtain CFIUS clearance, meaning that there is less risk that the President will deny the transaction at a later date.<sup>36</sup> The filing must contain a description of the transaction, inclusive of timelines and all assets to be acquired, as well as detailed backgrounds of all involved parties.<sup>37</sup> In particular, "[f]or the target U.S. company, the filing must identify . . . sensitive technologies or information it possesses and any U.S. government contracts to which it is a party."<sup>38</sup> For the foreign investor, the filing must include a report of future plans for the acquired firm and details of the intended ownership structure.<sup>39</sup>

Aside from reviewing voluntary filings, a member of the CFIUS can

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<sup>29</sup> Mamounas, *supra* note 1, at 391.

<sup>30</sup> *Id.*

<sup>31</sup> Matthew R. Byrne, *Protecting National Security and Promoting Foreign Investment: Maintaining the Exon-Florio Balance*, 67 OHIO ST. L.J. 849, 855 (2006).

<sup>32</sup> *Id.* at 855–56 (quoting 50 U.S.C. app. § 2170(e)).

<sup>33</sup> *Id.* at 856.

<sup>34</sup> Gotts et al., *supra* note 21, at 32.

<sup>35</sup> Mamounas, *supra* note 1, at 392.

<sup>36</sup> *Id.*

<sup>37</sup> Gotts et al., *supra* note 21, at 33.

<sup>38</sup> *Id.*

<sup>39</sup> *Id.*



also request review of a transaction that has not been voluntarily reported to the CFIUS by the parties. In this case, the parties are notified of the review and asked to submit the appropriate and required information.<sup>40</sup> For transactions that raise concerns, all parties engage in pre-filing consultations with the CFIUS, to modify the intended transaction as necessary.<sup>41</sup> The CFIUS often focuses on transactions where the target U.S. company has export-controlled technologies, technologies critical to national defense, or when the CFIUS has “derogatory intelligence” about the foreign investor.<sup>42</sup> The CFIUS also reviews transactions that may result in an absence of U.S.-controlled companies supplying technology or products that are critical to national security.<sup>43</sup>

### B. Critiques of the CFIUS and Exon-Florio

From the time of Exon-Florio’s 1988 enactment to 1999, the CFIUS only investigated approximately seventeen out of 1300 voluntary reports and of those seventeen, seven were voluntarily withdrawn.<sup>44</sup> In fact, only one divestiture of a foreign investment was issued in the era of Exon-Florio and the CFIUS: a 1990 case involving the acquisition of a U.S. aerospace manufacturer by a Chinese firm.<sup>45</sup>

As a result of the low and inconclusive statistics concerning their usefulness, both Exon-Florio and the CFIUS have been criticized for their effectiveness in regulating foreign investments in the United States. A leading criticism of Exon-Florio is that “national security” is never defined, which allows for a case-by-case determination of whether a transaction poses a threat to national security.<sup>46</sup> This could result in many varied interpretations of the national security standard, possibly dissuading foreign investors from investing in the United States and instead choosing other countries where the regulations are less ambiguous.

In terms of the CFIUS, critics have argued that it has carried out its duties in a “nonchalant” and “cavalier” fashion because of its focus upon specific transactions only, rather than on the synergistic and cumulative effect that multiple transactions will have on the nation’s defense industrial base.”<sup>47</sup> Others contest the nature of the CFIUS review process, arguing that it lacks the necessary transparency for effective oversight and the

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<sup>40</sup> Byrne, *supra* note 31, at 855.

<sup>41</sup> Gotts et al., *supra* note 21, at 33.

<sup>42</sup> *Id.* at 32.

<sup>43</sup> *Id.*

<sup>44</sup> Mamounas, *supra* note 1, at 392–93.

<sup>45</sup> Gotts et al., *supra* note 21, at 33.

<sup>46</sup> Stagg, *supra* note 5, at 336.

<sup>47</sup> Mamounas, *supra* note 1, at 393.

accountability needed to be taken seriously.<sup>48</sup> However, those in favor of the CFIUS recognize its position as a means for the federal government to monitor and restructure foreign investment transactions, noting that the “CFIUS enhances the national security when it identifies specific problems which could threaten U.S. security and helps resolve these problems while still allowing U.S. businesses to receive the capital they need.”<sup>49</sup> In this regard, the jury is still out on the effectiveness of the CFIUS, which contributed in part to the decision to reorganize and amend its review process and power.

#### IV. RECENT DEVELOPMENTS AND THE CURRENT STATE OF THE LAW

Following the September 11, 2001 terrorist attacks, national security standards were heightened and foreign transactions have since been viewed with greater scrutiny. A primary theme in U.S. government discussions post-September 11 has been the necessity and urgency for the United States to take a stronger defensive position, with border security becoming a “top priority.”<sup>50</sup> The CFIUS responded to the threat of terrorism by tightening the requirements for approval of foreign acquisitions and adding the Department of Homeland Security to its membership in 2003.<sup>51</sup> In light of these tougher requirements for foreign transaction approval, one of the most significant obstacles in the quest to improve border security has been achieving a balance between increasing attention paid to national security issues and maintaining the freedom of foreign investment and trade without reductions or delays, a balance paramount to the nation’s continued economic success. In the past decade, there have been several controversial transactions that have increased the number of foreign investment transactions deemed problematic and that have raised concerns over the quality of foreign direct investment regulations.

##### A. China National Offshore Oil Corporation’s Acquisition of Unocal (2005)

On April 4, 2005, California-based oil and natural gas company Chevron Corporation (Chevron) announced its intention to acquire another California-based company, Unocal Corporation (Unocal).<sup>52</sup> Following

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<sup>48</sup> *Id.* at 394.

<sup>49</sup> *Id.* at 395.

<sup>50</sup> Gregory W. Bowman, *Thinking Outside the Border: Homeland Security and the Forward Deployment of the U.S. Border*, 44 HOUS. L. REV. 189, 200–01 (2007).

<sup>51</sup> Stagg, *supra* note 5, at 342.

<sup>52</sup> Gaurav Sud, *From Fretting Takeovers to Vetting CFIUS: Finding a Balance in U.S. Policy Regarding Foreign Acquisitions of Domestic Assets*, 39 VAND. J. TRANSNAT’L L. 1303, 1304 (2006).

antitrust approval from the U.S. Federal Trade Commission, negotiations proceeded smoothly until China National Offshore Oil Corporation (CNOOC) made an unsolicited \$18.5 billion bid for Unocal on June 23, 2005 that topped Chevron's bid.<sup>53</sup> "CNOOC was created by the Chinese government 'in 1982 to be a joint venture partner with foreign oil companies exploring for offshore oil reserves'" and was considered to be one of the top fifty state-owned companies in China.<sup>54</sup> Despite potential advantages of the acquisition, Congress was wary of national security issues arising from a foreign company taking control of a domestic company in the energy market.<sup>55</sup> This concern stemmed from, among other reasons, the generous loans that CNOOC was receiving from state-owned banks and from its parent company, China National Offshore Oil, to fund its bid, which many viewed as "an effort by the Chinese government to overtake a private American oil company, rather than a pure commercial transaction."<sup>56</sup> On June 24, 2005, forty-one members of Congress sent a letter urging a thorough CFIUS review of the deal, stating, "energy security is a matter of significant and increasing importance for the [United States]" and that there was concern "about China's ongoing and proposed acquisition of energy assets around the world, including those in the [United States]."<sup>57</sup> In House Resolution 344, the House of Representatives recognized that the transaction "would result in Unocal's strategic assets . . . being preferentially allocated to China by the Chinese government, which would weaken U.S. ability . . . to influence the oil and gas supplies of the Nation through companies that must adhere to [U.S.] laws."<sup>58</sup> Further, the transaction would not only transfer significant natural resources from the United States to China but also create the possibility for certain technologies to be exported to China.<sup>59</sup> The Resolution cited concerns that through the acquisition of Unocal, CNOOC could take actions that would threaten the national security of the United States. This concern was echoed by the Armed Services Committee, which concluded in its own investigation in July 2005 that the concern lay not only in the United States' future access to oil but also in the idea that Communist China could control a U.S. corporation that dealt in a strategic natural resource.<sup>60</sup>

In order to allay the evident political and economic concerns, CNOOC

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<sup>53</sup> *Id.*

<sup>54</sup> Mamounas, *supra* note 1, at 403 (citation omitted).

<sup>55</sup> *Sud, supra* note 52, at 1305.

<sup>56</sup> Joshua W. Casselman, *China's Latest 'Threat' to the United States: The Failed CNOOC-Unocal Merger and Its Implications for Exon-Florio and CFIUS*, 17 IND. INT'L & COMP. L. REV. 155, 162 (2007).

<sup>57</sup> Mamounas, *supra* note 1, at 404.

<sup>58</sup> *Id.* at 405.

<sup>59</sup> *Id.*

<sup>60</sup> *Id.* at 406.

agreed to undergo a voluntary review by the CFIUS to “stress the key commitments that are an integral part of the friendly and open offer for Unocal.”<sup>61</sup> Despite its offer for voluntary review, political pressure and regulatory risk continued to rise, ultimately resulting in CNOOC’s withdrawal of its offer for Unocal, citing “unprecedented political oppression.”<sup>62</sup> Unocal shareholders ultimately voted to accept Chevron’s bid.

The result of this failed transaction was worldwide doubt of the viability of foreign investments in the United States. CNOOC vocally demonstrated its efforts and desire to make the deal work, stating, “CNOOC has given active consideration to further improving the terms of its offer, and would have done so but for the political environment in the U.S.”<sup>63</sup> For the United States, Unocal may have been able to benefit from a potentially more lucrative deal with CNOOC and the assets underlying exposure to the Chinese market. The failed transaction signaled to foreign investors that they should expect similar scrutinizing treatment when dealing with strategic assets and raised questions over the potential of China’s future interest in investing in the United States.

#### B. Dubai Ports World’s Acquisition of Peninsular and Oriental Steam Navigation Company (2005)

Shortly after the CNOOC-Unocal transaction fell through, Congress faced another challenge in balancing national security concerns with foreign investment transactions in the United States. Dubai Ports World, “a state-owned company located in the United Arab Emirates,” entered into an agreement to acquire London-based Peninsular and Oriental Steam Navigation Company (P&O), which ran port operations at six U.S. ports.<sup>64</sup> In October 2005, the two companies informally requested voluntary review by the CFIUS.<sup>65</sup> Nearly two months before the companies had the opportunity to formally file a request for review, the CFIUS requested an intelligence assessment of Dubai Ports World, which showed that the foreign acquirer had neither the intention nor the capability to threaten U.S. national security.<sup>66</sup> On December 16, 2005, the companies filed their formal notices with the CFIUS requesting a review, launching the thirty-day

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<sup>61</sup> Sud, *supra* note 52, at 1305.

<sup>62</sup> *Id.* at 1306.

<sup>63</sup> *Id.*

<sup>64</sup> Mostaghel, *supra* note 15, at 606.

<sup>65</sup> *Id.*

<sup>66</sup> Press Release, Dep’t of the Treasury, CFIUS and the Protection of the National Security in the Dubai Ports World Bid for Port Operations (Feb. 24, 2006), *available at* <http://www.treas.gov/press/releases/js4071.htm>.

formal review on December 17.<sup>67</sup> On January 17, 2006, the CFIUS agreed to allow the transaction to take place.

Approval of the transaction concerned many members of Congress who believed that in approving the purchase the government neglected national security considerations. Critics expressed concern over Dubai Ports World's acquisition, fearing that its control over domestic port operations posed a national security risk particularly because of "the UAE's history as an operational and financial base for the hijackers who carried out the September 11, 2001, attacks."<sup>68</sup> As a result, critics argued that a UAE-owned company could not be trusted with port security. In response to the widespread concern and doubt over the decision to approve the transaction, President Bush argued that "national security would not be harmed in any way by the operation of [Dubai Ports World] within these U.S. ports"<sup>69</sup> and that "the UAE could be trusted in this situation because it had provided assistance to and cooperation with the United States in the War on Terror."<sup>70</sup>

In the end, the critics' arguments were sufficient to raise congressional concern and the House Appropriations Committee voted on March 8, 2006 to block the transfer of the port terminals to Dubai Ports World.<sup>71</sup> The foreign acquirer responded by announcing its intention to "transfer" the U.S. terminal operation rights to a U.S. company.<sup>72</sup> Although the critics were appeased that the final decision took a more conservative angle, Dubai Ports World heightened concerns over the substance and viability of the CFIUS review process and raised questions over the need for enhanced legislation to clarify the CFIUS's roles and powers.

#### C. Smartmatic's Acquisition of Sequoia Voting Systems (2005)

Smartmatic, a privately-held software company ninety-seven percent owned by four Venezuelan founders, won contracts from U.S. competitors that allowed it to acquire Sequoia Voting Systems (SVS), a California-based company providing voting equipment.<sup>73</sup> Smartmatic was a small firm with little experience in voting technology until it was chosen by Venezuelan authorities to replace the country's election machinery.<sup>74</sup>

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<sup>67</sup> *Id.*

<sup>68</sup> Mostaghel, *supra* note 15, at 606.

<sup>69</sup> Byrne, *supra* note 31, at 878.

<sup>70</sup> *Id.* at 879.

<sup>71</sup> *Id.*

<sup>72</sup> *Id.*

<sup>73</sup> Shannon M. Haley, *A Shot Across the Bow: Changing the Paradigm of Foreign Direct Investment Review in the United States*, 32 BROOK. J. INT'L L. 1157, 1167 (2007).

<sup>74</sup> Tim Golden, *U.S. Investigates Voting Machines' Venezuela Ties*, N.Y. TIMES, Oct. 29, 2006, at 11.

Seven months before the voting contract was awarded to Smartmatic, a financing agency for the Venezuelan government invested in a smaller technology company that was owned by some of the same people as Smartmatic.<sup>75</sup> This resulted in the government agency receiving a twenty-eight percent stake in the smaller company, raising concern that the Venezuelan government may be able to hold influence over U.S. elections because of its connections to Smartmatic.<sup>76</sup> U.S. government representatives pushed for review of the Smartmatic-SVS acquisition, citing the importance of the government knowing who owns the voting machines. Despite public statements from Smartmatic's spokesman citing the transparency associated with Smartmatic's ownership and the certification by federal and state election agencies of SVS's electronic voting systems, U.S. government officials were still concerned that potential Venezuelan influence in U.S. voting systems presented a significant national security issue.<sup>77</sup>

On October 26, 2006, Smartmatic and SVS issued a press release announcing they voluntarily filed for review with the CFIUS.<sup>78</sup> However, before review had been completed, Smartmatic withdrew from the review process and announced its plans to sell SVS.<sup>79</sup> Despite the resolution of the immediate national security issue, there remained a general air of concern that the CFIUS was not well-prepared to investigate and report on the breadth and complexity of potential foreign investment issues.

#### D. Invest in America Initiative

On May 10, 2007, in light of these transactions and overarching concern over the sufficiency of foreign investment review and in an effort to express continued support for foreign direct investment in the United States, President Bush issued a statement reaffirming domestic commitment to advance open economies, open investment, and trade. It stated, "the United States unequivocally supports international investment in this country and is equally committed to securing fair, equitable, and nondiscriminatory treatment for U.S. investors abroad."<sup>80</sup> President Bush committed to ensuring that the United States remains the premier global investment locale and to advancing free and fair trade.<sup>81</sup>

One proposal to further foreign interest in investing in the United

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<sup>75</sup> *Id.*

<sup>76</sup> Haley, *supra* note 73, at 1168.

<sup>77</sup> Golden, *supra* note 74.

<sup>78</sup> Haley, *supra* note 73, at 1168.

<sup>79</sup> *Id.* at 1169.

<sup>80</sup> U.S. DEP'T OF STATE, UNITED STATES—JAPAN INVESTMENT INITIATIVE 2007 REPORT 12 (June 2007), available at <http://www.state.gov/documents/organization/86189.pdf>.

<sup>81</sup> *Id.*

States was the Department of Commerce's "Invest in America" initiative. The goal of this initiative was to educate international investors on the advantages of investing in the United States, focusing on outreach to foreign governments and investors, state governments, and businesses.<sup>82</sup> Through this initiative, the promotion of foreign direct investment in the United States is anticipated to increase, thus contributing to U.S. job creation and domestic competitiveness.

#### E. CFIUS Reform Legislation

Despite presidential support for foreign direct investment and the optimism generated by the Invest in America initiative, following the CNOOC-Unocal, Dubai Ports World-P&O, and Smartmatic-SVS transactions, members of Congress questioned the effectiveness of the CFIUS review process and Exon-Florio and demanded that more attention be placed on national security. At the time of these transactions, the CFIUS and Exon-Florio provided for a balance between national security and open foreign investment, taking an aggressive stance to ensure national security interests were preserved while open investment policies were still maintained.<sup>83</sup> However, the lack of a formal definition of national security in Exon-Florio and the freedom of the CFIUS to negotiate agreements with foreign firms without extensive oversight left many members of Congress questioning the consistency of reviews performed.

With Congress' increased focus on the CFIUS process, in 2006 alone, CFIUS launched seven forty-five-day investigations, which was the same number it had initiated in the previous five years combined.<sup>84</sup> Although the CFIUS was closely investigating many transactions that it may have quickly reviewed in the past, Congress pushed to ensure that national security issues continued to receive top priority in the review process. This resulted in various proposed legislation aimed at redefining the roles of the CFIUS and its review process.

##### *1. National Security Foreign Investment Reform and Strengthened Transparency Act of 2007*

In February 2007, the House of Representatives passed the National Security Foreign Investment Reform and Strengthened Transparency Act of 2007 (the Act), the first major piece of legislation focused on the CFIUS review process.<sup>85</sup> The Act proposed several changes to the CFIUS review process, including: (1) "granting [the] CFIUS the option to extend the

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<sup>82</sup> *Id.* at 13.

<sup>83</sup> Byrne, *supra* note 31, at 887.

<sup>84</sup> Gotts et al., *supra* note 21, at 33.

<sup>85</sup> *Id.* at 35.

review and investigation periods” on a case-by-case basis; (2) “requiring that an investigation of an acquisition by a government designated as a sponsor of international terrorism [] not be closed absent the President’s approval;” and (3) “requiring [the] CFIUS . . . to impose ‘evergreen provisions’ allowing reviews to be reopened in certain circumstances.”<sup>86</sup>

## 2. *Foreign Investment and National Security Act of 2007*

On July 27, 2007, President Bush signed into law the Foreign Investment and National Security Act of 2007 (FINSA).<sup>87</sup> Previously, under Exon-Florio, the President had the authority to suspend, prohibit, or seek to prevent a foreign merger with, acquisition of, or investment in a U.S. business. As highlighted by cited complaints, such presidential action rarely occurred because the CFIUS customarily resolved security issues prior to presidential review.<sup>88</sup> To address these concerns, FINSA broadens the authority of the CFIUS to cover infrastructure and technologies, strengthens the CFIUS’s review, and increases congressional oversight throughout the process.<sup>89</sup> By requiring heightened transparency in the review process, FINSA aims to monitor transactions between the CFIUS and the parties to the agreement to ensure that all national security concerns are properly addressed before a transaction is approved or dismissed. Among other things, FINSA (1) “retains the current thirty-day window for completion of the initial CFIUS review of a transaction,”<sup>90</sup> (2) “retains the current forty-five-day window for completion of a subsequent, second-level investigation where national security issues have yet to be mitigated,”<sup>91</sup> (3) “increases transparency by requiring reports to Congress and the public on completed reviews and investigations,”<sup>92</sup> and (4) “provides for civil penalties if parties to a transaction violate FINSA provisions, including mitigation agreements.”<sup>93</sup>

FINSA makes several improvements to the regulation of foreign direct investment by clarifying some of the ambiguities in the CFIUS review process. FINSA requires an initial review of all “covered transactions”<sup>94</sup>

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<sup>86</sup> *Id.*

<sup>87</sup> Michael J. O’Neil, *Did You Expect Less Scrutiny? After Dubai Ports World, Congress Broadens Review of Foreign Investment*, LEGAL TIMES, Sept. 17, 2007, at 41.

<sup>88</sup> *Id.*

<sup>89</sup> *Id.*

<sup>90</sup> *Id.*

<sup>91</sup> *Id.*

<sup>92</sup> *Id.*

<sup>93</sup> O’Neil, *supra* note 87.

<sup>94</sup> A covered transaction is “any merger, acquisition, or takeover that is proposed or pending after August 23, 1988, by or with any foreign person which could result in foreign control of any person engaged in interstate commerce in the United States.” Foreign Investment & National Security Act of 2007 § 2(a)(3) (2007).



that either the CFIUS decides to investigate or of which the CFIUS receives notification from the parties, ensuring that every transaction involving foreign investment receives attention from the CFIUS.<sup>95</sup> To advise transacting parties about the threshold of risk deemed acceptable by the CFIUS, FINSA requires that the CFIUS “issue guidance on the types of transactions previously reviewed that presented national security and critical infrastructure concerns.”<sup>96</sup> Further, in order to ensure the fulfillment of agreements or conditions issued by the CFIUS to transacting parties, CFIUS is required by FINSA to designate an agency to monitor the parties’ actions following the acquisition.<sup>97</sup> The CFIUS must also provide reports to Congress before July 31 of each year discussing all CFIUS reviews and investigations, including information on the types of transactions approved, statistics on the number of withdrawals, and information on the effects of monitoring arrangements designed to mitigate national security concerns.<sup>98</sup> All withdrawals from voluntary review must be approved and documented by the CFIUS to ensure proper due diligence by the transacting parties prior to committing to review.<sup>99</sup>

Perhaps most significantly, FINSA codifies the CFIUS and establishes it as “the President’s designee for purposes of Exon-Florio.”<sup>100</sup> This statutory basis for the CFIUS stabilizes the review process by firmly establishing the CFIUS’s members and their roles in implementing Exon-Florio and legitimizing the CFIUS’s authority within the U.S. regulatory scheme.<sup>101</sup> By heightening the required scrutiny applied to the transactions reviewed by the CFIUS and by increasing the oversight by Congress, FINSA serves to increase the CFIUS’s due diligence concerns and to enhance the monitoring of national security issues.

Despite the numerous advantages FINSA brings to foreign investment regulation, critics cite ways in which it threatens to negatively impact the U.S. economy and national security. By increasing congressional reporting requirements, it is argued that FINSA politicizes the foreign direct investment process.<sup>102</sup> Many members of Congress, once obtaining necessary security clearance, are granted access to confidential information pertaining to foreign investment transactions that have undergone CFIUS review. In addition, state senators with the necessary security clearance are allowed access to information about transactions involving companies that

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<sup>95</sup> Stagg, *supra* note 5, at 346.

<sup>96</sup> O’Neil, *supra* note 87.

<sup>97</sup> Stagg, *supra* note 5, at 345.

<sup>98</sup> O’Neil, *supra* note 87.

<sup>99</sup> *Id.*

<sup>100</sup> Stagg, *supra* note 5, at 346.

<sup>101</sup> *Id.* at 351.

<sup>102</sup> *Id.* at 352.

have a principal place of business in their respective state.<sup>103</sup> By allowing so many individuals access to this confidential information, there is the potential for foreign investment transactions to be used for political purposes, with special-interest groups gaining influence over the review process.<sup>104</sup> With increased congressional involvement in the CFIUS review process, there is an increased likelihood of pressure from both domestic competitors and target managers to propel, delay, or prevent certain proposed foreign acquisitions, which runs contrary to the intended purpose of foreign direct investment review.<sup>105</sup>

Aside from politicizing foreign investment transactions, there is also concern with the increased transparency and lack of confidentiality demanded by FINSA's new requirements. Critics contend that "FINSA compromises information sensitive to both national security and corporate competitiveness by allowing disclosure to more individuals than necessary to adequately investigate the transaction's national-security implications."<sup>106</sup> Despite assurances of confidentiality inherent in FINSA, the access of confidential information by a large number of people has the potential to discourage foreign investors from seeking investment and acquisition opportunities in the United States.

## V. IMPLICATIONS FOR FUTURE FOREIGN DIRECT INVESTMENT AND CROSS-BORDER DEALS IN THE UNITED STATES

It is undisputed that foreign investments and acquisitions in the United States have the potential to benefit the domestic economy, yet national security concerns over the increased opportunities for espionage and technology disruptions are paramount. In an effort to mitigate these concerns, regulations such as FINSA ensure that cross-border deals will be more heavily scrutinized prior to approval or dismissal. Undoubtedly, these heightened standards will affect the way in which foreign investment transactions take place.

For foreign acquiring companies, the reformed CFIUS review process has several implications. First, investors need to consider the additional time and risk of security reviews. These factors could prove to be a deterrent to potential investors who will not welcome the intense scrutiny and lengthy process necessary to begin finalizing their agreements. Second, foreign investors need to consider the costs and burdens associated with the CFIUS review process. There is a necessary expense and burden in

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<sup>103</sup> *Id.*

<sup>104</sup> *Id.* at 353.

<sup>105</sup> Susan W. Liebler & William H. Lash III, *Exon-Florio: Harbinger of Economic Nationalism?*, 16 CATO REV. BUS. & GOV'T. 44 (2008), available at <http://www.cato.org/pubs/regulation/regv16n1/v16n1-6.pdf>.

<sup>106</sup> Stagg, *supra* note 5, at 357.

generating the required information for the filings as well as the risk that the filing will raise issues that might have otherwise gone unnoticed.<sup>107</sup> Further, foreign investors need to consider concessions the CFIUS might require in order to approve the transaction. In past transactions, concessions have included, divesting from subsidiaries with sensitive technology and entering agreements concerning network security or government access to critical infrastructure.<sup>108</sup> Third, competing bidders for domestic acquisitions may use the CFIUS review process to their advantage by manipulating the system and making unsolicited or hostile bids. The existence of actual or potential investors who do not raise Exon-Florio or CFIUS issues may result in those investors paying a risk premium to compensate the target U.S. firm for the risk.<sup>109</sup> Investors who understand the review process may be able to make lower bids for acquisitions recognizing that they will get approved and potential competitors will not get approved for the transaction. In the case of hostile or unsolicited bids, foreign investors may try to use the CFIUS process to delay the closing of the transaction or give the Committee unfavorable information to harm a competitor and prevent the transaction from being approved.<sup>110</sup>

Aside from the implications for foreign acquiring companies, there are also implications for businesses in the United States. Recognizing the importance of foreign direct investment on the U.S. economy, it is possible that heightened review processes and intense scrutiny will have a negative effect on domestic businesses by causing foreign investors to develop dissuading perceptions of navigating national security standards in order to complete transactions within the United States. Further, target firms in the United States will need to take into account the additional time and risk associated with national security reviews in their own business decisions. Finally, it is possible that investors may change their own investment laws in an effort to circumvent national security requirements. Among other countries, Canada, China, and Thailand have all passed legislation creating new rules for foreign direct investments, including new screening requirements and reporting regimes.<sup>111</sup> The combination of these factors would prove detrimental not only to the newly issued regulations but also to efforts at taking advantage of globalization opportunities.

Despite the heightened review process requirements, there remains the threat of numerous risks for U.S. businesses pertaining to foreign investments. The increased scrutiny by the CFIUS will likely result in increased congressional comfort with foreign investment decisions. The

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<sup>107</sup> Gotts et al., *supra* note 21, at 34.

<sup>108</sup> *Id.*

<sup>109</sup> *Id.*

<sup>110</sup> *Id.*

<sup>111</sup> *Id.* at 35.

future of foreign direct investment in the United States is dependent on the creation of a balance between the short-term necessity for foreign investors to overcome heightened security standards and the long-term benefit of transparency in the CFIUS review process to ease concerns and encourage continued cross-border deals.

## VI. RECOMMENDATIONS FOR FOREIGN INVESTMENT CONTROLS IN THE UNITED STATES

Globalization and foreign investment are inescapable as mechanisms upon which the U.S. economy heavily depends. However, proposed transactions such as CNOOC-Unocal, Dubai Ports World-P&O, and Smartmatic-SVS highlight the necessity to balance national security needs and public and congressional concerns with the importance of domestic economic growth and development. The revised CFIUS review process under FINSA suggests the importance that the U.S. government places on foreign investments in the United States and the recognition of the significant economic benefits they afford. However, in order for the reformed legislation to be effective and appease the concerns associated with foreign investment deals in the past, Congress must ensure that it is not demanding adherence to a review process that is overly transparent or highly politicized.

In order to effectively encourage foreign direct investment and enforce national security standards, it is necessary for Congress to institute restrictions on the individuals who have access to confidential information about potential foreign investment transactions. The superfluous supply of corporate information and details surrounding foreign deals serves as a significant deterrent to potential investors overseas as well as to potential domestic target companies. By granting access to such information, FINSA enables mischief by special-interest groups that encourage their congressional constituents to thwart or delay the review or approval process.<sup>112</sup>

While it is necessary to provide a level of congressional involvement in the CFIUS review process, FINSA exaggerates this transparency and simultaneously risks losing foreign investments through current regulation. Through means such as more thorough details in the CFIUS reports to Congress, including the disclosure of the factors the CFIUS considers in determining national security implications of potential transactions,<sup>113</sup> Congress could establish transparency without threatening the confidentiality of corporate information or the politicizing of the CFIUS review process.

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<sup>112</sup> Liebler & Lash, *supra* note 105.

<sup>113</sup> Stagg, *supra* note 5, at 358.

## VII. CONCLUSION

Prior to the implementation of FINSA, the review process was permissive, discretionary, and discreet in terms of reporting and congressional notification requirements, suggesting that open investment was deemed a more important and significant priority to the U.S. government than national security standards. There was no firm stance on whether the inquiry underlying the review and investigation by the CFIUS would include consideration of the past conduct and future intentions of the foreign investor or the national origin of the investment, unless there was credible evidence of an impairment of national security.<sup>114</sup> Further, the three major foreign investment deals sparking interest in CFIUS reform (CNOOC-Unocal, Dubai Ports World-P&O, and Smartmatic-SVS) provide little basis for thorough evaluation of the effectiveness of prior law since all three investors withdrew their bids prior to completion of the CFIUS review process.

FINSA is a step in the right direction, adding some transparency and more complexity to the foreign investment review process, with increased scrutiny and a broader directive that will increase the number of transactions considered by the CFIUS.<sup>115</sup> Further, new congressional oversight and additional press focusing on the new review process will add to public consciousness of foreign acquisitions, making potential target firms also more aware of the importance of the review process.<sup>116</sup> Having been only recently implemented, it will take time before the success of congressional efforts at a heightened focus on national security interests will be determined. Unquestionably, the reform legislation furthers the goal of attaining the balance between the interests of the economy and those of national security. However, too much transparency and access to confidential information by too many individuals may prove to be a significant detriment to foreign investment transactions unless FINSA is properly amended to ensure the CFIUS review process continues seamlessly.

With no significant foreign investment deals having occurred since the implementation of FINSA and with the failure of CNOOC-Unocal, Dubai Ports World-P&O, and Smartmatic-SVS, it is difficult to assess foreign investors' interests in undergoing the critical review process and whether these past deals will deter foreign companies from investing in the United States. With foreign direct investment a critical component of the U.S. economy and also a key factor in the expansion of many international companies, it is likely that there will be many future investment

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<sup>114</sup> Haley, *supra* note 73, at 1173–74.

<sup>115</sup> O'Neil, *supra* note 87.

<sup>116</sup> *Id.*

transactions. The reformed CFIUS review process under FINSA provides a concrete measure for evaluating foreign investments and for ensuring that the CFIUS will do its part to make certain that the U.S. government protects not only trade but also national security. Execution of the review process requires consideration of the best interests of both the foreign investors and the domestic companies to make sure that a stronger national economy can be built without sacrificing the confidentiality of corporate information. This will ensure that the critical balance is maintained between the strong, attentive enforcement of national security standards and the maintenance of an open foreign investment policy.

