Exon-Florio 'safe harbour' threatened

Reforms to the secretive review process which vets foreign investment on national security grounds are jeopardising the finality and certainty of such deals.
By JEANNE ARCHIBALD and JEREMY ZUCKER

A law authorising the US President to review foreign direct investment on national security grounds – little known inside or outside the United States until the Dubai Ports World affair of 2006 – is now undergoing further scrutiny. Recent US Congressional activity and developing trends in the administration of the review process could undermine the traditional US posture of openness towards foreign investment and highlight the risks of uncertainty for foreign direct investors in the United States.

Despite its long standing, the CFIUS review process (see box) has only recently attracted public attention – first when the China National Offshore Oil Corporation attempted to purchase Unocal in 2005, and again when Dubai Ports World (DPW), a company owned by the government of Dubai, announced in 2006 its acquisition of P&O Steam Navigation Company, a British company that operated the port facilities of a number of major US cities. Notwithstanding the national security agreement entered into by DPW, CFIUS's approval of the transaction provoked significant criticism and prompted Congressional efforts to fortify the CFIUS review process. Alcatel's late 2006 acquisition of Lucent (including well-known Bell Labs, which performs highly classified work for the US Department of Defence) also generated considerable attention and concern.

These transactions and the Congressional proposals for reform appear to have given rise to two significant developments: the threat of substantial monetary penalties for non-compliance and the possibility that on the grounds of non-compliance the US government might require the unwinding of a transaction at any future point, notwithstanding prior clearance by the CFIUS.

A national security agreement generally takes the form of a contract between the US government and the transaction parties and typically contains enforcement clauses. Until recently, the US government took the view that the primary remedy for any breach of a national security agreement is strict compliance backed by the threat of court-imposed injunctive relief to compel performance. However, in the negotiation of a number of recent national security agreements, CFIUS agencies are reportedly seeking very high monetary penalties for breaches.

Even if opaque, the CFIUS review process at least has been viewed as providing clarity and finality to transaction parties. This, too, appears subject to change. CFIUS's clearance of the Alcatel/Lucent deal is reported to have included a so-called 'evergreen' provision, whereby the US government reserved the right to re-open the CFIUS review process at a later date, impose new conditions and, at its option, require that the transaction be unwound if Alcatel does not agree to additional commitments. The US and international business communities have raised concerns with the government on this score.

Nevertheless, an evergreen provision was also included in an Exon-Florio reform Bill (the National Security Foreign Investment >

> insolvency

Most European jurisdictions now provide for majorities of creditors to bind minorities to a restructuring proposal. However such schemes are in most countries only available within insolvency proceedings which, for the reasons discussed above, destroy value. Moreover, few European jurisdictions distinguish between different classes of creditors based on seniority. An exception is the UK scheme of arrangement, which recognises classes of creditors and allows a binding restructuring settlement outside insolvency proceedings, as happened in Telewest. English law might also allow the squeeze-out of 'out-of-the-money' creditor groups, but uncertainty on this point creates significant litigation risk – the issue was raised, but not resolved, in the restructuring of MyTravel.

Europe-wide reform?

The 2002 EC Insolvency Regulation did not even attempt to address the issues outlined above, merely regulating cross-border conflicts in insolvency proceedings. Whether it achieved even these limited goals is open to debate; the picture will be clearer when the European Court of Justice rules on the *Eurofood* case arising out of the Parmalat collapse (for more on this case see issue 62, page 16). Overall, the EU regulation is a timid measure that has had a limited effect on major restructurings. Indeed, there must be real doubt whether the creation of a substantive pan-European insolvency regime is an achievable goal for the European Union.

One alternative would be for European states to look to the UNCITRAL Model Law on cross-border insolvency. These rules mandate a broad freeze on any prejudicial creditor or debtor activity following an insolvency filing, while permitting the debtor company's business to continue operating until the courts decide how best to proceed. Although not as far-reaching as Chapter 11, adoption of these provisions would go significantly beyond the limited effects of the EU regulation, and would limit forum shopping more effectively. The Model Law has now been adopted in the UK and the US. It is to be hoped that more countries follow suit. ■

Reform and Strengthened Transparency Act of 2007) that passed the House of Representatives in late February 2007. If this legislation passes, the finality and certainty traditionally offered by the CFIUS review process will be replaced by an ongoing risk that a deal will be reopened. Among other noteworthy features, this Bill would allow for extension of the period of CFIUS review, a broadening of the scope of such review (the Committee now would consider not only the effects on US national security, but also the consequences for US efforts to curtail human trafficking and drug smuggling), greater input from the office of the Director of National Intelligence (which is not a CFIUS member), and significantly increased Congressional reporting and oversight. The Bush Administration and the business community have indicated their general support for this legislation.

In the prior session of Congress, the Senate passed CFIUS reform legislation viewed as more restrictive to foreign investment than its House counterpart – imposing a scheme of country assessment and classification and mandating much more extensive Congressional oversight – and sustained criticism from business groups. The US Senate has yet to take up an Exon-Florio reform bill in the current session, but it is expected to do so shortly, and enactment of final CFIUS reform legislation is likely this year. In a politically-charged environment, it is difficult to predict to what degree the open US investment climate will succumb to national security concerns. ■

The CFIUS review process

The Exon-Florio Amendment to the Defence Production Act of 1950 authorises the US President to bar or restrict acquisitions by non-US entities of US companies for reasons of national security if US law otherwise does not provide adequate protection. Exon-Florio review authority has been delegated to the Committee on Foreign Investment in the United States (CFIUS), a 12-member interagency committee chaired by the Treasury Department and including the Departments of Commerce, Defence, Justice, State, and Homeland Security, among others. Certain CFIUS agencies have as their mandate law enforcement, defence, and national security, while other agencies are focused on promoting open trade and investment.

Review of a transaction under Exon-Florio is not required by law. However, completion of the Exon-Florio review process without the President taking action to suspend, prohibit or otherwise restrict the transaction has been seen to create a 'safe harbour' for the acquiring party. Of the more than 1,700 reviews which have been initiated since the law was enacted in 1988, all have been voluntarily notified by the parties to CFIUS. The review process is confidential and the information submitted is exempt from disclosure. While some view the withholding of information from the public as undesirable 'secretiveness', others view it as essential protection for the companies under review, which need not fear the threats to competitive advantage that might otherwise result. The government's formal review may be completed in 30 days or, at the government's discretion, can be extended to a total of 90 days.

In certain instances, CFIUS clearance is granted on the condition that the transaction parties enter into an agreement with one or more US government agencies (such as the Departments of Defence, Homeland Security, and/or Justice) to mitigate any national security concerns raised by the transaction. Through such 'national security agreements', foreign acquirers make commitments with respect to, for example, the trustworthiness of employees occupying sensitive positions, or the location of sensitive data or equipment. Such commitments may impose operational burdens, but to date foreign acquirers have generally been prepared to accept them rather than forego the desired investment. ■