

National Foundation for American Policy

FOR IMMEDIATE RELEASE:
Thursday, January 25, 2007

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New Report Finds Process Has Grown More Difficult and Uncertain for Foreign Investors

Study Asks if Pendulum Has Swung Too Far

ARLINGTON, VA. – A new study finds that in the wake of the Dubai Ports World controversy, the process for securing approvals within CFIUS (the interagency Committee for Foreign Investment in the United States) has grown more difficult for foreign investors, adding to uncertainty and increasing the regulatory risk associated with certain foreign acquisitions. The National Foundation for American Policy (NFAP), an Arlington, Va.-based public policy group, requested the analysis by David Marchick, a partner at the Washington, D.C.-based law firm of Covington & Burling and a former official in the Clinton Administration. The study concludes, “The current uncertainty could inhibit investment in the United States. Reviews are taking longer, costs for companies have increased and CFIUS-imposed conditions are tougher.” A complete copy of the study can be found at www.nfap.com.

Last year, the attempt by Dubai Ports World to acquire certain U.S. port operations was one of the biggest news stories of 2006, with a remarkable 41 percent of Americans saying they followed the issue closely, only slightly less than followed the war in Iraq (source: Pew Research Center for the People and the Press). But what has happened since then? The NFAP analysis finds the more politicized environment surrounding CFIUS has created uncertainty for companies as to whether they should file a transaction with CFIUS. If a company does not file, then it risks CFIUS initiating its own review or opening a review after a deal has been finalized. Given CFIUS's limited resources, a climate that encourages companies to file with CFIUS for transactions with only a limited nexus to national security actually impedes CFIUS's ability to protect national security by compelling CFIUS staff to focus on acquisitions with few genuine security concerns.

“While CFIUS's primary responsibility is to protect national security, a process which creates greater uncertainty for investments unrelated to national security is unlikely to make America more secure. U.S. national security depends in part on the strength of the U.S. economy, access to leading technologies and our relations with other countries,” said David Marchick. “Therefore, Congress and the executive branch need to find the right balance to meet the twin objectives of protecting national security and promoting investment in the United States.”

“This paper highlights the critical importance of restoring certainty to the CFIUS process through reforms that protect our national security while welcoming foreign investment that creates jobs and

spurs economic growth in the U.S.," said Donald L. Evans, chief executive officer of the Financial Services Forum and former U.S. Secretary of Commerce, who participated in the release of the policy analysis.

"Limiting the pool of potential investors or buyers effectively lowers the value of U.S.-held assets in many sectors, harming business owners, their workers, shareholders and Americans with money invested in stocks, mutual funds, 401(k)s and pension funds," said Stuart Anderson, Executive Director of the National Foundation for American Policy. "The pendulum has swung too far and unless it shifts back toward the center, much-needed investment could be chilled and U.S. jobs and economic growth will be lost."

To restore confidence and certainty in the process, the analysis concludes the President should issue an executive order memorializing the significant changes CFIUS has already implemented and incorporating the positive elements of the House and Senate bills from the 109th Congress, being careful to consult with Members of Congress and also making clear America welcomes investment from abroad. At minimum, the executive order should establish regulatory guidance on the negotiation and enforcement of mitigation agreements. Mitigation agreements are an important tool for CFIUS to address national security concerns but should only address the marginal increase in national risk associated with a foreign acquisition as opposed to general security concerns that exist regardless of the ownership of a particular company.

"If Congress chooses to enact legislation it should use as a base and improve upon the bipartisan bill passed in the House of Representatives in 2006," concludes Marchick. On January 18, 2007, Representatives Carolyn Maloney (D-NY), Roy Blunt (R-MO), Barney Frank (D-MA), Deborah Pryce (R-OH) and Joseph Crowley (D-NY) introduced H.R. 556, which is the same bill that passed the House of Representatives last year.

The study points out the current statutory timeframes within Exon-Florio mirror the timeframes for antitrust reviews, putting foreign and domestic buyers on a level playing field. Maintaining the initial 30-day review timeframe is crucial for investors. Such legislation should also refrain from requiring CFIUS to notify Congress and governors about transactions before CFIUS completes its reviews.

The analysis identifies trends within CFIUS contributing to greater uncertainty for foreign investors:

- ***More filings, investigations, withdrawals and presidential decisions:*** In 2006, there were 113 filings (up 73 percent over 2005), 7 second-stage investigations (up 250 percent) and 5 withdrawals (up 150 percent) during the second-stage investigation period. A number of other transactions were withdrawn during the initial 30-day period. The dramatic increase in filings demonstrates that foreign investors and their counsel are increasingly uncertain about the approval process for foreign acquisitions, leading them to be much more cautious in deciding

whether and when to file transactions for CFIUS review. On top of that, the dramatic increase in the number of second-stage investigations and withdrawals suggests that foreign investors are having a much more difficult time closing transactions in a timely fashion. The stakes are high — in 2006 alone, just the transactions CFIUS reviewed whose value could be calculated based on public disclosures by companies (approximately one-third of CFIUS-reviewed deals) were valued at more than \$95 billion.

- **Longer reviews:** While statutory timetables have not changed, caution within CFIUS has resulted in longer review times, causing a growing number of transactions to be withdrawn within the initial 30-day period. Seven transactions required a full investigation. Other reviews took even longer. For example, Presidential approval of the Lucent-Alcatel merger came a full seven and one-half months after the merger was announced. If the pattern of longer time periods for CFIUS reviews continues, foreign investors will either be less interested in investing in the United States or U.S. companies will simply refuse to sell to foreign investors because of the risk of lengthy closing times for deals.
- **More mitigation agreements and new, unprecedented terms:** CFIUS has also increased the number of “mitigation” or “national security” agreements negotiated as a condition for approval. From 2003-2005, the Department of Homeland Security (DHS) was a party to just 13 mitigation agreements, compared with 15 such agreements in 2006 alone. Foreign investors — particularly in the IT sector and other sectors considered “critical infrastructure” — now face a greater likelihood of being compelled to enter into a mitigation agreement in order to secure CFIUS approval. CFIUS approval has commonly been understood to provide transaction parties with a legal “safe harbor” against a future divestment order by the President. This legal certainty has been an important prerequisite for foreign investors to invest in the United States. However, in the Alcatel-Lucent case, CFIUS required the parties to agree that the CFIUS review could be reopened and divestment potentially could be ordered if the “parties materially fail to comply with any of” the terms of a negotiated security agreement.

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About the National Foundation for American Policy

Established in the Fall 2003, the National Foundation for American Policy (NFAP) is a 501(c)(3) non-profit, non-partisan public policy research organization based in Arlington, Virginia focusing on trade, immigration and related issues. The Advisory Board members include Columbia University economist Jagdish Bhagwati, Ohio University economist Richard Vedder and other prominent individuals. Over the past 24 months, NFAP’s research has been written about in the *Wall Street Journal*, the *New York Times*, the *Washington Post*, and other major media outlets. The organization’s reports can be found at www.nfap.com.

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