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Research Report

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Foreign direct investment and U.S. national security: CFIUS under the Obama Administration

by

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There was considerable public scrutiny of the Obama Administration's performance in its inaugural year, but comparatively little focus on one of the Administration's key processes governing the flow of investment into the United States — namely, the Committee on Foreign Investment in the United States (CFIUS). Yet, this is a frequent question we receive from foreign investors -- has the change in the administration affected CFIUS?

The good news for investors and U.S. transaction parties alike is that the overall CFIUS process continues to function well under the Obama Administration and has been faithful to the principles of open investment. At the same time, there have been several notable developments in the volume and pace of CFIUS reviews over the past year that should be of interest to those who watch the cross-border M&A market closely.

The slowdown in overall M&A activity contributed to a reduction in filings with CFIUS.¹ In 2008, CFIUS reviewed 155 cases; CFIUS reviewed fewer than half as many transactions in 2009.² This is the lowest number of notices since 2005 and the first reversal of an upward trend in nearly a decade.

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¹ Through the first half of 2009, there was an estimated 86% reduction in overall M&A activity from 2008. Alexandria Zendria, "M&A in 2009," *Forbes* (July 14, 2009), available at <http://www.forbes.com/2009/07/13/mergers-acquisitions-technology-intelligent-investing-healthcare.html>.

² Final data on 2009 filings are not yet available, but the authors understand that CFIUS received notices for approximately 70 to 75 transactions in 2009.

Perhaps the most significant development for investors was that CFIUS's pace for completing its reviews also slowed materially in 2009. While official figures have not been released, CFIUS escalated a much higher percentage of matters under review to a second-stage 45-day "investigation" to the point that, by percentage, investigation nearly became the rule rather than the exception in 2009. By contrast, through 2007, fewer than two percent of all cases reviewed by CFIUS had proceeded to the investigation phase and, in 2008 (a year in which CFIUS received the most filings in nearly two decades), the number of investigations still was fewer than 15 percent of all cases.

The slower pace of CFIUS reviews and corresponding increase in investigations may be attributed to several factors. First, there was a natural bureaucratic lag that results from any change in Administration and turnover in senior positions in key agencies. The Treasury Department and other CFIUS agencies worked valiantly to move CFIUS cases along for review but often the necessary policy-level approvals were slow in coming.

Second, the Foreign Investment and National Security Act of 2007 (FINSAs), which "reformed" CFIUS and codified its review authority, established a presumption of investigation for foreign government transactions and transactions involving critical infrastructure. The number of investigations in 2009 partially reflects the continued role of state-owned enterprises and other sovereign investors even in the slower 2009 M&A market.

Third, and most important, the Executive Order (EO) adopted by the Bush Administration to implement FINSAs included several provisions aimed at tightening CFIUS's internal administration. In particular, the EO established a more rigorous internal process that CFIUS must undertake before it proposes measures directed at "risk mitigation" for a particular transaction. This internal process, while more disciplined and focused strictly on addressing only true national security issues, also creates an additional layer to the regulatory approval process. The result has been fewer mitigation agreements but a corresponding time lag due to the heightened formality of the internal mitigation process.

This trade-off between fewer mitigations agreements but longer CFIUS reviews has benefits and costs for transaction parties. Investors benefit as the trend reduces longer-term compliance costs associated with CFIUS approvals. On the other hand, delays in the average time for key regulatory approvals can potentially have a negative market impact, making foreign investors less attractive -- and, therefore, requiring higher prices from them -- than potential U.S. acquirors.

To be sure, there are reasons for optimism that equilibrium between mitigation and timing will be reached. Most key political positions with responsibility for CFIUS have been filled (after slow nomination and confirmation processes). As these officials become more comfortable with the inter-agency process, the processes established under FINSAs become more routine, and the internal precedent under FINSAs grows, the machinery of CFIUS will hopefully pick up pace and restore a balance between expeditious reviews and careful mitigation.

There also are measured steps that transaction parties can take to facilitate the review process. CFIUS encourages transactions parties to engage with CFIUS before filing. More consequential, transaction parties can anticipate and address ancillary regulatory issues -- such as necessary export control-related filings or compliance matters -- that involve member agencies of CFIUS to keep those issues distinct from the CFIUS

process. The failure to anticipate such issues can lead to their introduction into CFIUS's deliberations, delaying CFIUS approval until they can be separately sorted with the particular member agency.

Notwithstanding this dynamic nature of CFIUS's considerations and the concerns over the timing delays over the past year, CFIUS in many ways remains a model for preserving open investment while balancing national security considerations. Placing the process in some perspective, it is remarkable that a government regulatory review that requires not just coordination but *consensus* from roughly a dozen federal agencies, each of which has its own perspective and equities — and each of which may itself require coordination among many internal offices and components — can be completed in the vast majority of cases within the statutory timeframes (either 30 or 75 days) and with little controversy. And yet this has been, and remains, the regular achievement of the CFIUS process.

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