

## Client Memorandum

June 29, 2007

To: Clients and Friends

From: Covington & Burling LLP

Re: Senate Passage of CFIUS Reform Bill (S. 1610)

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Earlier today, the Senate passed S. 1610, the "Foreign Investment and National Security Act of 2007," by unanimous consent. The bill is substantially similar to the version we analyzed in our last update on May 16, 2007. The final bill as passed by the Senate reflects minor comments received from the Treasury Department, which chairs CFIUS, and the House of Representatives, in particular Congressmen Barney Frank and Spencer Bachus, the Chair and Ranking Member of the House Financial Services Committee. As a result, this version of the bill is expected to be adopted by the House of Representatives without any changes. Following passage by the House, the bill will be sent to the President for signature.

Latest amendments to Senate bill

Prior to passage, several amendments were made to the Senate bill. The amendments were mostly minor technical changes, but some are worth noting.

- *Penalties.* Prior to these amendments, the bill authorized the President to direct the issuance of regulations imposing civil penalties for "any violation" of the Act. The final bill now clarifies that a violation includes violations of "any mitigation agreement entered into or conditions imposed" by CFIUS. Still left unanswered, however, are questions such as who will determine what constitutes a violation, whether there will be a materiality threshold and how the penalties will be administered. These will be important issues for the regulations, which must be issued within nine months.
- *Critical infrastructure.* The amendments revise the definition of the term "critical infrastructure" to apply only to systems or assets "so vital to the United States that the incapacity or destruction of such systems or assets would have a debilitating impact on national security." The amendments helpfully deleted even broader text that would have defined national security to include "national economic security and national public health or safety."
- *Covered transaction.* The amendments clarify that the legislation encompasses "covered transactions" dating to the original enactment of the statute in 1988.

Except for these changes, the final bill remains consistent with the analysis contained in our last client alert.

Key provisions of the Senate bill

- *Statutory responsibility and membership.* The bill gives CFIUS the authority to review and investigate covered transactions, and to negotiate, impose, and enforce conditions necessary to mitigate any threat to national security presented by such covered transaction. The bill also confirms the Secretary of the Treasury as the Chairman of the Committee, and lists six members (the Secretaries of Homeland Security, Commerce, Defense, State, and Energy, and the Attorney General), and two agencies in an ex officio capacity (the Secretary of Labor and the Director of National Intelligence). It preserves authority for the President to designate additional members, including the heads of White House agencies, as appropriate.
- *Timing.* The bill maintains the timeframes that exist under current law. Specifically, reviews must be completed within 30 days after CFIUS receives notice of a covered transaction or re-opens a review pursuant to the “evergreen” provision. Investigations must be completed within 45 days after they begin.
- *Investigation triggers.* A transaction will be subject to investigation if, after a 30-day review, any of the following apply: (1) the transaction threatens to impair the national security of the United States and the threat has not been mitigated during review; (2) the transaction is a foreign government-controlled transaction (discussed below); (3) the transaction would result in foreign control of any critical infrastructure and could impair national security, unless the impairment has been mitigated during the review period (discussed below); or (4) the lead agency (discussed below) and CFIUS agree that an investigation should occur.
- *Guidance on transactions with national security implications.* The bill requires CFIUS to issue guidance on the types of transactions that have been reviewed and that have raised national security considerations. The guidance will specifically address transactions that involve foreign control of critical infrastructure. The guidance is to be published within 180 days of the legislation’s effective date (the effective date is 90 days after the date of enactment).
- *Lead agencies.* The bill creates additional authority for agencies with the greatest equities in a transaction by adopting the concept of a “lead agency or agencies” for each transaction. Appointed by the Treasury Department, the lead agency will be responsible for negotiating mitigation agreements on behalf of CFIUS and will be charged with monitoring and enforcing these agreements.
- *Senior-level involvement.* The bill requires the involvement of senior-level officials, including with respect to certifications provided to Congress, decisions not to investigate covered transactions involving foreign government ownership or certain transactions involving critical infrastructure, and decisions to re-open an investigation under the “evergreen” provision (discussed below).
- *Foreign government-controlled transactions.* The legislation creates a presumption of investigation for covered transactions involving investment by state-owned entities (“SOEs”). However, the Secretary or Deputy Secretary of the Treasury, and an equivalent official at the lead agency, may waive this investigation requirement if they determine that the proposed transaction will not impair national security. For those acquisitions by SOEs that reach the investigation stage, the bill requires an assessment of the foreign country’s compliance with U.S. and multilateral counter-terrorism, nonproliferation and export control regimes.

- *Transactions involving critical infrastructure.* As noted, the legislation effectively codifies existing practice. Specifically, transactions that would result in foreign control over critical infrastructure and could impair national security will go to a second-stage investigation unless the impairment has been mitigated during the review period.
- *Expanded list of factors for national security consideration.* The bill expands the expressly enumerated factors that CFIUS should consider in assessing the national security impact of a transaction. The expanded list essentially codifies factors that CFIUS already considers (e.g., the risk of technology transfer to a country that is a threat to the U.S.; the impact of a transaction on critical infrastructure and critical technologies; foreign government ownership; and when there is foreign government ownership and a transaction is subject to an investigation, that government's cooperation on counter-terrorism, nonproliferation, and export control matters).
- *Evergreen provision.* The bill helpfully creates tight control on the use of the “evergreen” CFIUS provision. CFIUS can re-open transactions previously reviewed or investigated if any party to the transaction (a) submitted false or misleading material information to CFIUS; or (b) materially breaches a mitigation agreement. However, the bill makes clear that CFIUS can only re-open a transaction for a material breach if there is a finding of intentional breach by the lead agency and a finding by all of CFIUS that no other remedies are available.
- *Expanded DNI involvement.* The proposed legislation makes the Director of National Intelligence (DNI) an ex officio member of CFIUS and requires the DNI to analyze the national security threats posed by covered transactions, engage the intelligence community, and report findings to the committee within 20 days of commencement of the CFIUS review.
- *Comprehensive post-decisional reporting to Congress.* Under the bill, Congress will receive written notice at the conclusion of the CFIUS process for all reviews and investigations. These reports must provide details about the transaction and written assurance that the transaction either does not threaten to impair national security or that mitigation agreements have addressed any concerns. The bill also requires detailed annual reports to Congress on the activities of CFIUS, including information on the transactions that have been reviewed or investigated within the previous 12 months.
- *Congressional oversight and notification.* The bill provides that any of the Members of Congress who receive all the required notices and reports (i.e., those holding leadership positions, not the state- or district-specific Members who only receive certain notices and reports) may request a briefing on the transaction or compliance with any mitigation agreement or condition imposed with respect to the transaction. Briefings may be classified, as appropriate, and provided to such Members' staff having the necessary security clearance.

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The action by the Senate marks a significant step toward the final adoption of CFIUS reform legislation. As we have advised previously, we believe this legislative development, which codifies many existing practices of CFIUS, will lead to greater regulatory clarity and cool political pressures on transactions — two outcomes that will be positive for the investment environment and will help create further distance from last year's Dubai Ports World controversy and fall-out.

We will continue to keep you apprised of the legislative and policy developments on CFIUS reform. Please let us know if you have any questions on this important issue.

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