

# CNOOC And U.S. Foreign Investment Rules: Today's "Screen" May Be Tomorrow's "Wall"

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The recent effort by the China National Overseas Oil Company (CNOOC) to acquire the U.S. oil company Unocal unleashed what can only be described as a firestorm of opposition. The motivations for that opposition were mixed, and included pure political efforts to "kill" the CNOOC bid, a hostile climate of opinion in Washington about China, and perhaps some legitimate concerns about the potential impact of such an acquisition on the national security of the United States. However, whatever the motivation, the opposition ultimately manifested itself in a series of legislative actions that focused on the laws and structures in place allowing the United States government to screen mergers, acquisitions and takeovers of U.S. assets by foreign entities. Although CNOOC ultimately withdrew its bid for Unocal, the debate over how and to what extent such foreign investment should be regulated continues, and proposals that Congress may be debating this year could change existing regulations dramatically. Should those changes occur, the United States could become much less attractive to foreign investors, and the trade deficit dollars that return to the United States from foreign investment could begin migrating to other, more welcoming venues.

Under the so-called "Exon-Florio" provision of U.S. law, the President has the authority to accept, reject, or require changes in mergers, acquisitions or takeovers that result in the ownership or control of U.S. entities by foreign persons. The standard by which the President is to exercise that authority is based on the potential impact of the proposed transaction on the national security of the United States. If the proposed transaction involves a non-governmental foreign acquirer, then the President is to judge whether the transaction "will...threaten to impair the national security." If the proposed transaction involves an acquisition by an entity that is controlled or acting on behalf of a foreign government, the standard for possible Presidential action is whether the transaction "could affect the national



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security."

Once the President makes one of the threshold determinations described above, the Exon-Florio provision allows the President to act only if he determines that there is no other provision of U.S. law that can address the national security concerns raised by the transaction.

The President's determinations are to be made on the basis of an investigation, which may be conducted by officials that the President designates to implement the law. The Presidential designee in the case of the Exon-Florio law is an inter-agency group called the Committee on Foreign Investment in the United States (CFIUS), which is led by the Treasury Department and has 12 government agencies as regular members. Parties to transactions subject to the Exon-Florio law may voluntarily notify CFIUS of a proposed transaction, or CFIUS may otherwise become aware of such a transaction. CFIUS has 30 days to conduct an initial review of a proposed transaction. If during that review CFIUS determines the transaction does not raise national security concerns, the transaction is considered "cleared."

If CFIUS determines that there are national security questions that need further review, CFIUS may undertake a formal investigation, which may take up to an additional 45 days. Again, as a result of this investigation CFIUS may clear the transaction, request that the parties make changes in the terms, or indicate that it has identified serious national security concerns that warrant final review by the President. Presidential review is limited to an additional 15 days, at which time the President must decide whether to reject, approve, or ask for modifications in a proposed transaction. Determinations made under Exon-Florio are not reviewable in U.S. courts.

The CFIUS review process is strictly confidential, is designed to impose minimal burdens on most transactions in terms of delay (with a maximum review period of 90 days), and attempts, to the greatest extent possible, to protect transactions from political intervention.

These attributes stem from the concerns that were expressed at the time the Exon-Florio law was enacted — that while it was legitimate to put in place a national security "screen" for foreign acquisitions of U.S. assets, that screen should recognize and respect the historic U.S. policy of welcoming foreign investment, because it brings back to the United States billions of dollars used to purchase imported goods, and because it creates new economic opportunities for American workers. Moreover, limiting the criteria for possible rejection to national security concerns reflects the fact that the overwhelming volume of foreign investment in the United States is benign, and that transactions warranting scrutiny are extraordinary and should be treated as such. Finally, it was acknowledged that unless steps were taken to isolate the process from political pressures, the United States would lose substantial credibility in its efforts to create an open investment climate for American companies in other countries.

Since enactment of the Exon-Florio law in 1988, about 1,500 transactions have been notified to CFIUS. Of those, 25 have been subject to a 45-day investigation, and one has been referred to the President and subsequently rejected. While some critics had argued that this record indicated that the CFIUS process was inadequate to "catch" potentially problematic acquisitions and needed strengthening, until the CNOOC bid they offered no evidence of any transaction that had in fact threatened the national security of the United States, however that term might be defined. Those involved in the CFIUS process could testify to the fact that the agencies involved utilize the initial 30-day review to examine proposed transactions rigorously to assure that national security issues have been addressed under a variety of other U.S. authorities, and do not hesitate to "stop the clock" by asserting a lack of complete documentation until concerns can be addressed.

Despite the substantially positive record, the CNOOC bid has now opened the CFIUS process to an organized and bipartisan congressional effort that may result in very dramatic and potentially harmful changes. Key members of Congress last year offered amendments to the Exon-Florio law as part of the debate on the Defense Appropriations Act. While these amendments ultimately were not adopted, some members have vowed to press their provisions during the 2006 congressional session.

Possible changes in the law are:

1. Extending the period of CFIUS initial review to 60 days from the current 30 days.
2. Requiring CFIUS to send the results of every investigation to the President, and to the Senate Committee on Banking, Housing and Urban Affairs

and the House Committee on Financial Services.

3. Allowing the chairmen of those committees to request that CFIUS investigate a transaction involving an entity controlled by a foreign government.

4. Requiring, in every case in which a transaction is not suspended or prohibited, that the transaction be reviewed by Congress before it can be consummated. Congress would be given up to 40 "legislative days" to pass a resolution of disapproval of a transaction, which the President could sign or veto. The reference to "legislative days" opens a transaction to long and uncertain delays since legislative days are only those days on which Congress is in session. If a transaction were under congressional review at the time Congress adjourned for the year, it could be held up for up to three months.

5. Adding "energy security" and "economic security" to the areas to be investigated and evaluated in reviewing transactions.

6. Changing the coordinating agency from the Treasury Department to the Commerce Department.

Critics also continue to warn that China's objectives in investing in the United States should be uniformly suspect and to imply that in general U.S. investment policy should be hostile to China.

If the proposals, which are quite clearly and unapologetically intended to politicize the foreign investment review process and weaken confidentiality protections, are enacted into law, the predictable consequence will be that foreign investors, and most certainly not just Chinese investors, will rightly see the United States as no longer committed to an open-investment climate. They will feel much more free to utilize their dollars to buy assets in other countries where the rules are similar to current U.S. law. It is worth noting in this regard that China is attracting very high levels of foreign direct and portfolio investment and is carefully liberalizing its investment regulation.

The argument that "Unocal could not buy CNOOC" may or may not be true, but recent news reports indicate that U.S. companies in the media and other sectors are quite free to buy major stakes in Chinese companies, or to enter into joint operating arrangements with Chinese companies in major industries. If the Exon-Florio law is changed in the ways now being proposed, such an investment might be considered "off limits" in the United States. Americans could be faced with the criticism that U.S. investment rules are more exclusionary than those of China. If that becomes the case, the criticism will not come solely from China — it will be widespread, and foreign investors will "vote with their feet."

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