

EXECUTIVE DECISION:
A LEGAL CRITIQUE OF THE COMMITTEE ON
FOREIGN INVESTMENT IN THE UNITED STATES
IN THE AFTERMATH OF THE IBM-LENOVO DEAL

BY

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Today, we live in a troubled world, and our America is a nation much more aware of its security, both in the nature of “homeland” and “national.” Addressing the latter, we are fortunate that the obsession with, if not the occasional paranoia of, “national security” has greatly lessened since the end of the Cold War. Nevertheless, national security is still a matter of paramount importance in ensuring the safety and prosperity of our nation. And in assuring our prosperity, we see that national security often takes on an aspect of safeguarding our economic and business interests. This is particular so with insulating vital American industries from potentially dangerous foreign control or influence.

This was evidenced most recently with IBM’s proposed sale of its PC business to Lenovo Group Ltd., the largest personal computer maker in the People’s Republic of China. To be sure, China may be America’s largest trading partner; but that has not stopped it from being antagonistic at times to our national interests. Thus, this proposed combination of high technology giants was not destined to be any ordinary corporate acquisition. The citizenship of the proposed buyer triggered the necessity of review of a

relatively unknown, but nevertheless extremely powerful government group, the Committee on Foreign Investment in the United States, called “CFIUS” in bureacratese.

Almost nothing is known about the internal functioning of this body, for reason of the highly sensitive nature of its deliberations, and there is precious little on the record which details its operations. However, considering that the respective economies of the United States and the world only continue to become more global and multinational, and thus deals such as IBM/Lenovo will continue to happen, it behooves both businesses and the counsel advising them to have some awareness of the legal underpinnings of CFIUS and the legal framework in which it operates. Albeit working with limited resources, the purpose of this article is to impart as much information as is publicly available to corporate, financial, and legal dealmakers, and provide them with some guidance when confronted with such matters as controversial as national security.

The current CFIUS was formulated in late 1988, pursuant to what are commonly called the “Exon-Florio” amendments to the Cold War era’s Defense Production Act of 1950.¹ The new law empowered the Chief Executive to investigate and, if necessary, block foreign takeovers of American businesses on national security grounds.²

Then-President Ronald Reagan constituted the Committee and delegated power to it via executive order, and put the Secretary of Treasury in charge.³ Pursuant to that authority, the Treasury Secretary has promulgated regulations governing the functioning of CFIUS.⁴

The Treasury Secretary (or his designee) acts as chair, and is joined at CFIUS by eleven other Cabinet members and executive department heads; the Secretaries of State, Defense, (and most recently) Homeland Security, Commerce, the Attorney General, as head of the Justice Department, and the President's National Security Advisor. Other CFIUS members are the U.S. Trade Representative, and representatives from each of the Office of Management and Budget, the President's Council of Economic Advisers, the Assistant to the President for Economic Policy, and the Office of Science and Technology.⁵ As chair, the Secretary of the Treasury may invite representatives of other agencies to participate, as he deems appropriate.⁶

When CFIUS is at work, it is charged with reviewing the national security implications of particular corporate takeovers, and each member of the Committee is responsible for reviewing the proposed merger or acquisition from the perspective of their area of expertise within the Executive branch. "Given the national security-related nature of the CFIUS review process, it is generally protected from public disclosure, subject only to certain exceptions."⁷

The specific mandate of CFIUS, pursuant to the 1988 law, is to investigate and determine “the effects on national security of mergers, acquisitions, and takeovers...by or with foreign persons which could result in foreign control of persons engaged in interstate commerce in the United States.”⁸ If a proposed merger or acquisition implicates the national security concerns safeguarded by the Exon-Florio amendments, the involved parties are required by federal regulation to give notice to the Committee.⁹

If the Committee deems an inquiry is justified, then that investigation must commence no later than 30 days after the Executive branch receives written notification of the impending deal.¹⁰ Interestingly, if the Committee makes a unanimous decision not to undertake an investigation, the matter is closed, and CFIUS shall take no further action.¹¹ Clearly, this was designed to provide closure for the affected parties, as non-action by the Committee within the proscribed time frame brings certainty that no questions linger and they may proceed with their transaction. Parenthetically, it should be noted that the legislative history contemplates that if the Executive branch does not act in the aforementioned 30 days after receiving notice of a potential transaction, the President is foreclosed from acting to prevent the merger.¹²

Once it is determined that an investigation is warranted, CFIUS has 45 days in which to complete its work.¹³ As could be expected, if the Committee decides to investigate, then the businesses in question typically provide detailed presentations to the Committee, via documents and sometimes via appearances and discussions, to address any national security issues.¹⁴ Information and documents filed by the parties with

CFIUS are deemed confidential, and are immune from disclosure pursuant to the Freedom of Information Act, and can only be made known in limited circumstances.¹⁵ For example, it can be disclosed to the Congress or any authorized Congressional committee.¹⁶

Not much is said about what CFIUS is supposed to address in its inquiry. After all, matters of national security can be (and usually are) fairly broad and subject to differing interpretations.¹⁷ The statute provides guidance that items to be considered to determine any risk to national security include defense production, the capability and capacity of U.S. industries to meet national defense requirements, and, notably, “the control of domestic industries and commercial activities by foreign citizens as it affects the capabilities and capacity of the United States to meet the requirements of national security.”¹⁸ The last is a rather broad parameter, and would seem to bestow the most latitude upon the Committee to act upon what it deems to be a matter of national security.

CFIUS will make a report to the President upon the completion or termination of its investigation, and simultaneously issue a recommendation.¹⁹ Its report will include all information relevant to national security issues. If the Committee is not unanimous in its recommendation to the President, the chair will present the differing views of the Committee for the Chief Executive’s further consideration.²⁰

The Committee can only make reports and recommendations to the Chief Executive; it cannot act by itself, as it is only an investigative body. If there are national security concerns, then the President must make specific findings that “there is credible evidence...to believe that the foreign interest exercising control might take action that threatens to impair the national security,” and other legal avenues do not, in the President’s judgment, provide “adequate and appropriate authority for the President to protect the national security” with respect to the proposed transaction. Critically, such findings by the Chief Executive are not subject to judicial review.²¹ However, the requirement that the President make explicit findings as to the proposed transaction’s impact on national security speaks to the need for a well reasoned decision by the Chief Executive.

Obviously, such definitive findings by the President would be significant in and of themselves. However, their real power is felt by what they are a precursor to. Upon making such findings of a threat to national security, the President is then empowered to take such action for such time as the Chief Executive deems appropriate to “suspend or prohibit any acquisition, merger, or takeover, of a person engaged in interstate commerce in the United States” by a foreign entity.²² Clearly, quite a grant of power to the President to completely prohibit a contemplated deal.

If the President decides to act in the interests of national security, the Chief Executive must make an announcement within 15 days after CFIUS completes its investigation.²³ In addition, the President may direct the Attorney General to proceed to the federal courts and seek appropriate judicial relief to enforce his orders.²⁴ If the President does act pursuant to this statutory power, he must immediately report both the action and the mandatory factual findings underlying that action in writing to the Congress.²⁵ We can deem this public disclosure as evidence of a check and balance upon presidential power. In sum and substance, that is the law creating and governing CFIUS and its inner workings, insofar as they are known.

For reason of its confidential nature, we can look to only a few scattered instances of the Committee in action. One recent and public example of the power of CFIUS is found in the bankruptcy reorganization of failed telecom giant Global Crossing. Reported as In re Global Crossing Ltd.,²⁶ the debtor's plan of reorganization called for it to emerge from bankruptcy by means of a combined purchase by two Far Eastern buyers.

But there was a hitch; one of the purchasers was “a Hong Kong entity, and Hong Kong is now under the political control of the People's Republic of China.”²⁷ In the proceedings before him, Bankruptcy Judge Robert Gerber acknowledged that the presence of the PRC government behind the scenes “plainly made securing approval from CFIUS, which focuses in significant part on national security concerns, difficult or

impossible.”²⁸ As observed by the bankruptcy court, the process of securing the Committee’s approval was moving apace, but there was no assurance it would ever be granted. Ultimately, the Hong Kong buyer withdrew its part of the bid, due to these CFIUS concerns, and the debtor’s reorganization was financed by the remaining purchaser.

Most recently, and as widely publicized, Lenovo’s purchase of IBM’s personal computer business was in fact approved by CFIUS. The government approved the estimated \$1.25 billion (U.S.) acquisition, with the seller “overcoming national security concerns” when IBM included as part of the transaction the blocking of Lenovo’s access to the identity of federal government customers and going so far as to physically sealing off buildings in a North Carolina office park the two companies will occupy after the sale. It was reported that CFIUS members from the Departments of Justice and Homeland Security were especially concerned about Chinese infiltration of computer systems within the federal government, and the physical embargo of the two buildings was demanded by federal officials due to a perceived threat of industrial espionage.²⁹

One can only imagine, and without being fanciful, the national security concerns that necessitated such strong measures. After all, Lenovo is at least influenced, if not controlled, by its founder, the Chinese Academy of Sciences, a branch of the PRC government.³⁰ The restrictions come as no surprise, given the obvious sensitivity of the identity of IBM's customers in the U.S. government, let alone of information to be gleaned from doing business with them, and the high value of computing technology in military applications, which no doubt drove the demand for a physical separation. Notably, the companies' acquiescence and the Committee's approval came as the statutory 45 day review period was nearing its end, and after CFIUS had commenced a formal investigation at the behest of leading Congressional members who were seeking to delay the sale and then conduct a more extensive probe.³¹

At the end of the current day, where does this leave American (and even foreign) businesses and their legal counsel? We know precious little about the interior workings of CFIUS, its predilections or its modes of analysis. The statutory framework which created the Committee ensured that it would be able to function well out of the public spotlight, and for good reason. Obviously, the highly sensitive nature of the national security issues which the Committee grapples with demands secrecy, lest the very security the Committee is mandated to preserve would be at grave risk.

Furthermore, there is the very salient point that CIFUS is a creature of the Executive branch, comprised of members of the Article II departments, and largely populated with Presidential appointees and confidantes. That is not a criticism; it merely points out the fact that the constituent members of the Committee change at least with every change of administration at the White House, if not more often. In addition to changing the appointees, no doubt points of views and priorities change with the prevailing winds of politics, diplomacy, and policy, both foreign and domestic. As could be expected in our great democracy, CIFUS is consistently viewed by some as too interfering, and by others as too passive. All that can be said to those who might have business before the Committee in the future is that a keen awareness of the opinions and agendas of the group's members is an absolute necessity.

We can address the legal, and, more particularly, the statutory infrastructure of CIFUS with greater certainty, since the controlling law is fairly lucid. First, the Exon-Florio amendments provide an explicit and fairly tight timetable for executive action. Once notice is served on CIFUS via the Treasury Department, the Committee has a comparatively short thirty days in which to decide whether or not to proceed. Potential corporate partners can take some comfort that within a month the government will either act or not. If the latter, then the Committee's silence is consent, and the Executive branch is prohibited from future action or revisiting the proposed transaction, at least on these national security grounds.

In the event CIFUS deems it wise to investigate, once more a reasonable time frame is activated. In any business deal, forty five days is not all that long a time, and it is certainly vastly superior to other methods of governmental “investigation” that could drag on for months, thus stifling well founded deals. Yet another positive aspect of the functioning of CIFUS is that it is highly confidential, with minimal risk of disclosure. Such confidentiality is not to be underestimated by businesses in a competitive and sometimes hostile environment.

More importantly, CIFUS does not operate in a vacuum. Even with what little we know of its inner secrets, the scant case law tells us that the proposed takeover partners are given their day to present their best case to the Committee, and in fact possibly more than once. Indeed, it is a fair assumption that in recent inquiries the affected parties were permitted not only to respond to inquiries to CIFUS, but had the chance to allay the government’s national security concerns. There is every appearance, and in the future there can be every expectation, that the CIFUS process will provide ample opportunity for interaction, discussion, and negotiation. In short, the proposed merger partners will not only have their chance to be heard, they will be afforded an opportunity to modify their deal in such a way as to remove obstacles based upon concerns for the nation’s security.

At the same time, the process gives the Chief Executive ample means to provide for the national defense. First, the very mechanism itself gives the President the luxury of having his top Cabinet officers or their designees (presumably possessed of the specialized qualifications to make them particularly well suited for the task) apply all the great powers of investigation and analysis to the situation at hand. Assured that his top people are on it, and that the law mandates they deliver to the White House a detailed report of the Committee's findings, the President will have ample due diligence in hand to support a final decision. To be sure, that is another key aspect, and one not to be underrated; the Committee, with all respect still a group of political appointees, does not have the final say. Only the elected President can make an executive decision.

If the President decides national security demands action, it is within the Chief Executive's rights to simply shut down the deal. That would of course be decisive, but also note well that the President can also employ the Justice Department to seek other and proper relief in court as well. This not only gives the President options, it involves the Judicial branch in its proper constitutional role of reviewing executive action. Now looking at a distance, one can better appreciate the foresight of the Legislative branch in enplacing this further check and balance into the process. All things considered, CIFUS and the process statutorily required by Exon-Florio works well, albeit in the shadows, to ensure national security.

What is the future for CFIUS and the law it operates under? Concomitantly, what is the future for contemplated mergers and acquisitions between American and foreign companies? There was enough of a public outcry against the IBM/Lenovo deal to embolden certain elements to potentially seek modifications to the law. Indeed, with the PRC, among others, awash in billions of U.S. dollars, some business groups are calling to empower the Committee to prohibit deals on economic grounds as well.³² As we have seen, CFIUS is clearly limited to only investigating and making recommendations to the Chief Executive, and must base its actions upon national security concerns alone. But that can change, if Congress so desires.

Could we see a strengthening of CFIUS and its powers to influence or even block proposed acquisitions of American corporations by foreign buyers? Might the scope of the Committee's inquiries be expanded from the present grounds of only national security to encompass economic issues or additional matters as well? Is it possible that the process would be made more open to public scrutiny? What if Congress decides to exercise greater oversight of the process, or perhaps even reclaim the power of review from CFIUS? After all, what is done by Congress can be undone. While not aware of specific proposals, many outcomes are possible.

In closing, it remains to be seen how CIFUS will function in the future, if it will continue as it has or is the subject of great change. But for now, matters of national security, including the potential merger of American businesses with foreign entities that implicate such concerns, will remain a matter of executive decision and executive orders.

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¹ Codified at 50 U.S.C. App. § 2158, et seq. (as amended). CIFUS was first organized in 1975 simply to monitor foreign investment in the United States. Executive Order No. 11,858 (May 7, 1975), 40 F.R. 20263, reprinted at 15 U.S.C. § 78b note. See also U.S. Department of Treasury CFIUS, Exon-Florio Provision, available at www.treas.gov/offices/international-affairs/exon-florio/.

² 50 U.S.C. App. § 2170. See Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, Title V, § 5021, 102 Stat. 1107, 1425, et seq. (1988).

³ Executive Order No. 12,661 (December 27, 1988), 54 F.R. 779, reprinted at 15 U.S.C. § 78b note (hereinafter “Exec. Order 12, 661”). See also Interim Memoranda of President (October 26, 1988), 53 F.R. 43999, reprinted at 50 U.S.C. App. § 2170 (Historical and Statutory Notes).

⁴ See 31 C.F.R. § 800.101, et seq. (1992), cited by LTV Aerospace and Defense Co. v. Thomson-CSF, S.A. (In re Chateaugay Corp.), 155 B.R. 636, 645 n.10 (Bankr. S.D.N.Y. 1993) (“LTV I”), affirmed, 198 B.R. 848 (S.D.N.Y. 1996) (“LTV II”).

⁵ Exec. Order 12,661. See also LTV I, supra.

⁶ Exec. Order 12,661.

⁷ In re Global Crossing Ltd., 295 B.R. 720, 722 (Bankr. S.D.N.Y. 2003) (ordering an in camera review of CFIUS materials, and not permitting public disclosure, “by reason of national security nature of the information in question”).

⁸ 50 U.S.C. App. § 2170(a)

⁹ 31 C.F.R. § 800.402(b)(5), cited by LTV I, supra, 155 B.R. at 645 n.10. See also Exec. Order 12,661.

¹⁰ 50 U.S.C. App. § 2170(b). See also Exec. Order 12,661.

¹¹ Id.

¹² See H. R. Conf. Rep. No. 576, 100th Cong., 2d Sess. 925 (1988), reprinted in 1988 U.S. Cong. & Admin. News 1547, 1958.

¹³ 50 U.S.C. App. § 2170(b). See also H.R. Conf. Rep., supra.

¹⁴ See, i.e., LTV II, supra, 198 B.R. at 853

¹⁵ 50 U.S.C. App. § 2170(c). See also Exec. Order 12,661.

¹⁶ 50 U.S.C. App. § 2170(c). See also 31 C.F.R. § 800.702, followed by Global Crossing, supra, 295 B.R. 720, 724-25.

¹⁷ See H. R. Conf. Rep., supra, at 926, U.S. Code Cong. & Admin. News at 1959 (legislative history declares “[t]he term ‘national security’ is intended to be interpreted broadly without limitation to particular industries.”)

¹⁸ 50 U.S.C. App. § 2170(f).

¹⁹ Exec. Order 12,661.

²⁰ Exec. Order 12,661.

²¹ 50 U.S.C. App. § 2170(e).

²² 50 U.S.C. App. § 2170(d). See LTV II, supra, 198 B.R. at 852 n.3, citing 31 C.F.R. § 800.101 (discussing history of how bid by French defense firm, at the time owned by the French government, to purchase the missile business of the bankrupt LTV Company was withdrawn after vociferous Congressional opposition and a CFIUS inquiry).

²³ Id.

²⁴ Id. See also H. R. Conf. Rep., supra, at 927, U.S. Code Cong. & Admin. News at 1960 (legislative history states “appropriate relief” is a deliberately broad term, intended to give the President flexibility to deal with any foreign control attempt that might pose a threat to national security).

²⁵ 50 U.S.C. App. § 2170(g). Parenthetically, the statute further provides that, in the case of “an assessment of the risk of diversion of defense critical technology,” said assessment shall be provided to the Executive branch member responsible for that sector, 50 U.S.C. App. § 2170(j), and the President or the President’s designee shall make a quadrennial report to the Congress on any “coordinated strategy by 1 or more countries or companies” to acquire U.S. firms involved in critical technologies, and also report on industrial espionage conducted directly or indirectly assisted by foreign governments against American companies “aimed at obtaining commercial secrets related to critical technologies.” 50 U.S.C. App. § 2170(k). See also 50 U.S.C. App. § 2170a(a) (prohibiting purchase of U.S. defense contractors by entities controlled by foreign governments); 50 U.S.C. App. § 2170b(a) (mandatory report by President to Congress on foreign industrial espionage).

²⁶ 295 B.R. 726 (Bankr. S.D.N.Y. 2003).

²⁷ Id. at 732.

²⁸ Id.

²⁹ Moody, “Lenovo’s purchase of IBM PC Unit Wins U.S. Clearance,” (March 9, 2005, Update 4), available at www.bloomberg.com/apps/news?pid=71000001&refer. See also Kessler, “Congressmen Scrutinize IBM, Lenovo Deal,” (January 28, 2005) *USA Today* at 5B; Crock, “Seeing Red Over Big Blue’s China Deal,” (February 14, 2005) *BusinessWeek* at 45 (reporting of national security issues being raised by Homeland Security and the FBI regarding Chinese access to military applications and encryption technology).

³⁰ Id.

³¹ Id.

³² See BusinessWeek, supra.