



National Security Law Report

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Amendments to Exon-Florio Law

Foreign Investment in U.S. National Security Businesses

by Lucinda Low

Introduction

On October 23, 1992, President Bush signed into law the National Defense Authorization Act for Fiscal Year 1993, which includes amendments to the so-called "Exon-Florio" legislation.¹

Exon-Florio, or more technically, Section 721 of the Defense Production Act of 1950,² authorizes the President to suspend, prohibit, or undo (through divestiture) *acquisitions of control by a foreign person of a U.S. person* where such acquisition impairs, or threatens to impair, the U.S. national security. Acquisitions falling within the scope of the statute are subject to a "voluntary" notification procedure, with notices being submitted to an inter-agency committee, the Committee on Foreign Investment in the United States ("CFIUS").

Under the law as originally enacted in 1988, CFIUS had complete discretion to determine whether notified acquisitions should be subject to a full investigation. CFIUS's recommendations ensuing from any investigation would be submitted to the President for a final determination, which had to be based on certain specified considerations relating to the U.S. national security. A presidential decision to intervene in a transaction was a "last resort" action, which could

only be made after certain conditions were satisfied. Each step—the decision by CFIUS whether to investigate following notification, the completion of an investigation, and a Presidential determination—was subject to strict timetables.

The 1992 amendments to Exon-Florio represent a contraction of executive discretion in implementing the statute in certain circumstances and a potential expansion of the types of transactions to which Exon-Florio may apply.

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Senator DeConcini Addresses Breakfast

by Jackson R. Sharman III

The Chairman of the Senate Select Committee on Intelligence, Senator Dennis DeConcini (D-Ariz.), spoke to a crowded breakfast meeting on April 22, 1993 at the International Club. Senator DeConcini offered several comments on the remarks given to the February breakfast meeting by former Director of Central Intelligence Robert Gates. He said he was gratified that Dr. Gates had called for more, rather than less, congressional oversight of intelligence activities. Although the Senator stated that in his view the Central Intelligence Agency has not always "played it straight" with the Senate Committee, he conceded that the Committee may not have always asked the right questions.

Senator DeConcini disagreed with Dr. Gates's assertion that Senate Intelligence Committee staffers exert undue power and influence. He said that the staff frames issues and makes administrative choices, but the substantive decisions are made by the members, not by the staff. Senator DeConcini joined with Dr. Gates in deploring the differences between the oversight committees that authorize intelligence activities and the committees that provide appropriations for those same activities, pledging to reduce or eliminate such disparities in the future.

Noting that the system is far from perfect, Senator DeConcini argued that the oversight system in the

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Background to the Amendments

Earlier in 1992, the proposed acquisition by a French government-controlled entity, Thomson, of the missile division of LTV Corp., a U.S. defense contractor, caused congressional concern over the administration of Exon-Florio to rise to a fever point. Since Exon-Florio (which was originally enacted as part of the 1988 omnibus trade bill) became effective, more than 700 transactions have been notified to CFIUS. Of those, only a fraction (15, or approximately 2%) have been subject to a full investigation, and in only one case — involving an acquisition of an aerospace company by the Chinese government — has the President exercised his divestiture authority. Although these numbers understate the effect of the legislation — because in many cases the acquirer has given undertakings or has agreed to structural changes designed to neutralize or eliminate any national security problems, or the acquiree has made changes to its operations in anticipation of CFIUS review — there has been nonetheless a perception among some that the law is being implemented too narrowly. Further, because of confidentiality requirements set forth in the legislation, the executive branch has limited ability to explain to a critical Congress its reasons for permitting a particular transaction to go forward.

In the Thomson/LTV case, a full investigation was undertaken by CFIUS. Before CFIUS could forward its recommendation to the President, however, Thomson, in response to extensive criticism of the acquisition, withdrew its offer for LTV. That criticism stemmed mainly from the poor record of the French government in preventing diversions of militarily-sensitive technology to undesirable countries such as Iraq.

The incident highlighted concern over the acquisition of defense contractors by foreign firms, especially foreign governments. Congressional critics of CFIUS took the view that, with such acquisitions being likely to increase as a result of the contraction of the U.S. defense industry currently underway, tougher measures were necessary to ensure that such acquisitions received the necessary scrutiny.

Nature of the Amendments

The amendments to Exon-Florio thus *require* an investigation of any acquisition having national security implications by "an entity controlled by or acting on behalf of a foreign government."³ They also require the immediate submission to the Congress of

a written report of the President's determinations in such cases, which report is to detail the factors considered and the findings made by the President.⁴ Prior law required such a report only if the President decided to block a transaction.

A third provision of the amendments expands the list of factors the President must consider in assessing a threat to the U.S. national security.⁵ The factors in the original legislation were:

- (1) "domestic production needed for national defense requirements;
- (2) the capability and capacity of domestic industry to meet national defense requirements . . . , and
- (3) the control of domestic industries and commercial activities by foreign citizens as it affects the capability and capacity of the United States to meet the requirements of national security."

The factors added by the amendments are:

- (1) "the potential effects of the proposed or pending transaction on sales of military goods, equipment, or technology" to any country supporting terrorism, and any country of concern regarding the proliferation of nuclear technology, missiles or chemical and biological weapons; and
- (2) "the potential effects of the proposed or pending transaction on U.S. international technology leadership in areas affecting U.S. national security."

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June 3-4 at the International Club

Conference to Examine "Anarchy in the Third World"

The last few years have witnessed dramatic international change in a wide range of areas. The collapse of the former Soviet Union; the spread of Democracy in Russia, Eastern Europe, and elsewhere; and the effective functioning of the United Nations Security Council during and after the Persian Gulf conflict are but three positive examples. Sadly, however, this period has also been accompanied by a variety of new problems. From famine and feudal strife in Somalia to civil war and "ethnic cleansing" in Bosnia/Herzegovina, there has been an alarming growth of disorder—a problem apparent especially in such Third World countries as Cambodia, Lebanon, Liberia, Angola, Mozambique, the Sudan, Columbia, and Peru. To date, the world community has struggled with the issue of what role it should play, if any, in connection with such crises.

To address some of these issues, the Standing Committee will sponsor a conference on "Anarchy in the Third World" at the International Club, 1800 K St., N.W., Washington, D.C., on Thursday and Friday, June 3-4, 1993. While responses were still being awaited from some invited participants at press time, the number of prominent experts who have already accepted virtually assures that the conference will make an important contribution to understanding these important issues.

Following welcoming remarks at 8:30 AM by Standing Committee Chairman John Shenefield and the framing of the issues by former Chairman John Norton Moore, the first panel will provide an overview of anarchy and government breakdown. Chaired by the Honorable Samuel W. Lewis (former Ambassador to Israel and President of the U.S. Institute of Peace, who currently serves as Director of the Policy and Planning Staff at the State Department), the panel will include Chester A. Crocker (USIP Board Chairman and former Assistant Secretary of State for African Affairs), Dr. Alberto Coll (former Principal Deputy Assistant Secretary of Defense for Special Operations and Low-Intensity Conflict), Professor Murray Feshbach of Georgetown University, and Professor W.

Scott Thompson of the Fletcher School of Law & Diplomacy at Tufts University.

The remaining three panels on Thursday and the initial panel Friday morning will provide four case studies: Somalia (including former U.S. Ambassador to Somalia Robert Oakley and Special Assistant to President Clinton Richard A. Clarke), Bosnia/Herzegovina (including Permanent Representative of Bosnia and Herzegovina to the United Nations Muhamed Sacirbey and former Ambassador to Yugoslavia John D. Scanlan), Haiti (moderated by President Alan Weinstein of the Center for Democracy and including University of Chicago Law School Dean Diane Wood), and Cambodia. Three additional panels on Friday will look at ways to strengthen the United Nations and regional organizations to deal with anarchy and government breakdown (including former U.N. Ambassador Elliott Richardson and Columbia Law School Professor Richard N. Gardner), modalities of intervention and their parameters (which will address a range of options from mediation to military action—including the specific targeting of regime elites), and the legal limits on humanitarian intervention (including Colonel James P. Terry, the Legal Adviser to the Chairman of the Joint Chiefs of Staff, and law professors Tom J. Farer of American University, Malvina Halberstam of Yeshiva University, and Fred L. Morrison of the University of Minnesota).

Thursday's lunch speaker will be the Honorable Max M. Kampelman, former chief arms control negotiator and Ambassador to the Conference on Security and Cooperation in Europe. Congressman Steny H. Hoyer (D-Md.) has also agreed to take part in the conference.

All sessions will be open to the public at no charge, however a \$40 fee will be collected to cover the costs of the two luncheons. The deadline for reservations is May 21. Individuals wishing more information or desiring to register for the conference are urged to contact Ms. Holly McMahan, the Standing Committee's Staff Director, at (202) 466-8463.

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The amendments also require the FBI and the CIA to submit to the Congress periodic reports evaluating whether any foreign companies or countries have a strategy to acquire, through the acquisition of U.S. companies, defense critical technologies.⁶

Finally, the amendments suggest that CFIUS's membership be expanded to include the Director of the Office of Science and Technology Policy and the Assistant to the President for National Security.⁷

Effect of the Amendments

Clearly, the current circumstances of the U.S. defense industry may create opportunities for foreign acquisitions of U.S. technology or other assets which could prove detrimental to the U.S. national security. Whether these amendments create a suitable process for identifying those transactions which pose such risks is another question.

Requiring an investigation of such acquisitions presupposes that all relevant transactions will come to the attention of CFIUS. While this seems likely, it is not guaranteed given the overall structure of Exon-Florio. A cornerstone of Exon-Florio is that notification of CFIUS by the parties to a transaction is voluntary, not mandatory. Thus, if a foreign government elects not to notify CFIUS in a given case, the transaction would have to come to CFIUS's attention through other avenues. For instance, a member agency could become aware of a proposed transaction and report it to CFIUS. But is this certain to occur, and can one be confident it will occur on a timely basis? The answers to those questions are not obvious.

Having a report required for every investigation of proposed foreign government acquisitions will likely have two effects: First, it will put pressure on the Executive Branch to justify its decisions, particularly its decisions not to intervene. Although encouraging reasoned decisions is always desirable, the fear of scrutiny may in this area skew the results of Executive Branch deliberations. Second, a reporting obligation may deter potential foreign acquirers in close cases or in cases where there would be reasons to want to avoid congressional scrutiny and possibly public exposure. It must be remembered in this regard that congressional review is not judicial review, but political review, and thus will be subject to political agendas.

While one might assume that these political forces would invariably cut against a foreign acquirer, that may not always be the result. For instance, an acquisition that was borderline in terms of national security

might nonetheless be viewed as desirable by certain members of Congress if it would prevent the closure of a U.S. plant or a loss of jobs in their districts.

By expanding the list of factors to be considered in assessing the existence of a threat to U.S. national security, the amendments have effectively redefined and broadened the concept of U.S. national security for Exon-Florio purposes. The first new factor expressly imports "North-South" proliferation threats into the Exon-Florio assessment process. These threats are recognized in other U.S. regulatory contexts; for instance, in the export-control area. There is widespread agreement that these constitute a part of the new universe of U.S. security concerns, and their express inclusion under Exon-Florio seems appropriate.

The second new factor is more interesting. The phrase "U.S. technology leadership in areas *affecting* national security" (emphasis added) appears to go well beyond technology which is primarily military in character. It could, for example, be applied to such industries as computer hardware and software, and telecommunications. If applied broadly, it could represent a significant expansion of Exon-Florio into the arena of "economic security".

A second key variable influencing how broad an effect the amendments will have is how the term "entity controlled by or acting on behalf of a foreign government" will be interpreted by CFIUS. It seems likely that whether there is foreign government "control" in a given case will be decided by reference to the definition of that term in the existing implementing regulations for Exon-Florio.⁸ That is a relatively broad term, which looks to functional, not just formal, control. As a result, it could embrace not only foreign government ownership of an entity, but regulatory decisions which have the effect of directing an entity's action. The term "acting on behalf of," on the other hand, has no reference point in the regulations. Other legislation, such as the Foreign Agents' Registration Act, will probably therefore be the principal

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Calendar of Events

June 3-4 — Conference on Anarchy in the Third World (International Club)

June 4-5 — Committee Meeting (Mayflower Hotel)

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source of guidance to CFIUS on the meaning of that term. The term suggests the existence of an agency relationship; if that is in fact how it is interpreted, then the amendments will result in a significant expansion of the scope of Exon-Florio.

Conclusions

In sum, the 1992 Exon-Florio amendments can be seen as accomplishing several distinct but significant changes:

- Updating the statute to deal with the new generation of security threats;
- Reducing executive discretion with regard to foreign government (broadly defined) acquisitions;

and, finally and perhaps most significantly,

- Expanding the concept of national security for Exon-Florio purposes to include technology that "affects" national security.

Whether the new Administration will feel compelled to seek further changes to the statute remains to be seen. Arguably, the "economic security" concept that Clinton Administration officials have asserted should be part of the national security equation could be quietly introduced into the process without the need for legislation or regulations given the undefined character of the term in the statute. In this author's view, that would be bad policy. Exon-Florio is one of those uneasy compromises between the needs of national security and the needs of commerce. The executive owes it to business to be as clear as possible about what activities are viewed as raising security threats. At the least, therefore, any significant changes to the concept ought to be reflected in regulations or other interpretive releases by CFIUS.

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Senator DeConcini ...

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United States has worked fairly well for the last seventeen years, and pointed out that many foreign countries send delegations to visit with both members and staff from the Senate Committee. He had recently returned from Romania, which faces enormous problems in attempting to establish oversight systems of its own.

Senator DeConcini noted that the overarching issue for intelligence agencies today is the question of resources. Funding increased dramatically during the 1980s, he observed, but decreased significantly this past year. Senator DeConcini agreed that there was no less need to know the intentions and capabilities of other nations simply because the Soviet Union no longer exists, but he said that the goal of particular programs and the amount of money available would be the determinative questions in the future. He cited both the CIA's economic analysts previously dedicated to the Soviet Union and the national overhead reconnaissance systems as two examples of programs that could benefit from a thorough review.

In conclusion, Senator DeConcini identified four areas of current interest to the Committee: economic intelligence, which the Chairman supports and believes should be the subject of hearings; the environment, because the intelligence agencies have amassed data that would be useful in resolving environmental problems; the coordination of intelligence and law enforcement activities, the failure of which came to light in the BNL and BCCI cases; and new openness in intelligence matters, coupled with a potential restriction or reduction of counterintelligence programs.

Mr. Sharman is Associate Editor of the Report.

The full text of Senator DeConcini's remarks will appear in the next issue.

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The National Security Agenda

State Department Reports 36% Decline in International Terrorist Attacks in '92; names Iran as most dangerous sponsor of terrorism—On 30 April the Department of State released its annual report on *Patterns of Global Terrorism*. It reported a drop from 567 incidents in 1991 to 361 last year, with 1992 marking a 17 year low in such attacks. Two Americans were killed and one wounded last year—the lowest such figures since the department began collecting such data 25 years ago. Iran was identified as “the most dangerous sponsor of terrorism” during 1992 and was credited with the 17 March truck bombing of the Israeli Embassy in Argentina (which killed 29 and wounded 242) and more than 20 other incidents around the world. The department attributed much of the decline in terrorist attacks to the collapse of Communist regimes in the Soviet Union and Eastern Europe, many of which had been training, funding, or providing other support to international terrorist groups. Although North Korea and Syria were not directly linked by the department to any specific terrorist incidents in 1992, they remain on the department’s list of States that sponsor terrorism (along with Cuba, Iran, Iraq, and Libya) because they continue to harbor groups long identified with international terrorism. The report covered incidents occurring during 1992, and thus did not include the 26 February 1993 bombing of the World Trade Center in New York, which killed six and wounded more than 1,000.

Iraqi-Sponsored Attack on Former President Bush Thwarted in Kuwait—In a related story, Reuters reported a Kuwaiti Government announcement on 27 April that a 17-member terrorist group had been apprehended shortly before former President George Bush’s mid-April visit to that country. According to the report, the group possessed about 180 pounds of explosives and planned a suicide attack to assassinate the former American president. Sheik Ali Sabah Salem Sabah, the Kuwaiti Defense Minister and Acting Interior Minister, alleged that the arrested individuals “were agents of Iraqi intelligence.”

Egypt Charges Iran and Sudan with Terrorism—Egyptian President Hosni Mubarak charged on 26 April that Iran and the Sudan were supporting Muslim terrorists in Egypt who had attempted to assassinate Egypt’s information minister on 20 April and engaged in other acts of terror.

U.S. Spy Satellite Photos Shared with IAEA—In a dramatic departure from past practice, on 22 February the United States showed highly sensitive satellite photographs to representatives of the International Atomic Energy Agency in an effort to demonstrate North Korean violations of the Non-Proliferation Treaty. According to the *Washington Post* (27 April), representatives of Libya, Algeria, and Syria were present when the dramatic evidence was unveiled. CIA analysts reportedly opposed disclosing the photographs on the grounds that knowledge of the resolution of U.S. overhead systems might prompt potentially hostile States to take counter-measures to avoid future detections, but former DCI Robert Gates reportedly overruled the objections and the Clinton White House concurred that the benefits of disclosing DPRK treaty violations warranted the risks.

Poll Reports 71.6% of Panamanians Favor U.S. Military Presence After 1999—A poll published in the Panama City daily *La Prensa* reported that 71.6% of 1,201 Panamanians polled favored a continued U.S. military presence in Panama after the 1977 Panama Canal Treaty expires on 31 December 1999, while 18.5% favored the withdrawal of American troops as scheduled.

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If those changes are contrary to congressional intent (as the rejection of “essential U.S. commerce” in the original U.S. legislation suggests), then new legislation may be necessary.

Lucinda A. Low is a member of the Standing Committee and Vice Chairman for Business Law of the ABA Section of International Law and Practice.

¹ Pub. L. No. 102-484, §837 (1992).

² Codified at 50 U.S.C. App. §2170.

³ §837(a)(2), adding a new subsection(b) to 50 U.S.C. App. §2170.

⁴ *Id.* sub. §(e), amending 50 U.S.C. App. §2170(g) (formerly (f)).

⁵ *Id.* sub §(b), amending 50 U.S.C. App. §2170(f) (formerly (e)).

⁶ *Id.* sub §(e).

⁷ *Id.* sub §(d).

⁸ 31 C.F.R. §800.204 (1992).