Mining for Meaning: Assessing CFIUS’s Rejection of the Firstgold Acquisition

By
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INTRODUCTION

After a period of relative calm, the dissolution of a proposed Chinese takeover of the U.S.-based mining firm Firstgold Corp. threatened to resurrect controversy surrounding national security reviews of foreign acquisitions. Such reviews, conducted by the Committee on Foreign Investment in the United States (CFIUS), drew considerable attention in 2005 and 2006, when public outcry led foreign firms to abandon two major U.S. acquisitions. In 2005, an effort by the China National Offshore Oil Corporation (CNOOC) to purchase California-based Unocal generated strong opposition on Capitol Hill, leading CNOOC to abandon the deal. Less than one year later, Dubai-based DP World divested its U.S. port operations after succumbing to congressional and public resistance. In response to these and other high-profile transactions, some observers argued that the U.S. review process failed to identify genuine national security threats, while others feared that the politicization of individual acquisitions would deter benign foreign investments. Nevertheless, controversy over the CFIUS review process had recently abated, following a series of legislative reforms, the emergence of an improved congressional oversight regime, and a decline in foreign investment activity due to the global recession.

This period of quiet met its first significant challenge in December 2009, when Firstgold announced that CFIUS would advise President Barack Obama to block an investment in the company by Northwest Non-Ferrous International Company Limited, a Chinese firm.¹ In July 2009, Firstgold had indicated that Northwest would acquire a majority of its outstanding shares as part of a $26 million deal.² The parties made a CFIUS filing on October 5, but learned one month later that the committee would be initiating an additional 45-day investigation. In a December 18 statement, Firstgold revealed that due to “serious, significant and consequential national security issues”—specifically, the proximity of mining facilities to the Fallon Naval Air Station and other nearby military installations—CFIUS had refused to approve the deal.

This brief article argues that although the Firstgold acquisition appears to have failed due to extraordinary circumstances specific to this transaction, the timing and context of the incident could nevertheless contribute to fears of U.S. protectionism. The article proceeds as follows. First, Part I provides a brief background on the development of the CFIUS process. Next, the article assesses the Firstgold transaction, focusing in Part II on

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Firstgold’s striking disclosures regarding its discussions with the committee. Finally, Part III explores broader implications of this transaction for U.S.-Chinese economic relations and U.S. foreign investment policy generally.

I. THE EVOLUTION OF CFIUS

CFIUS, an interagency body chaired by the Treasury Department, has gone through several incarnations since its creation in 1975. In response to congressional unease with growing foreign investment from oil-producing states, President Gerald Ford issued an executive order establishing the committee. In its original form, CFIUS was tasked with monitoring the effects of foreign investment. However, the executive order delineated no process by which the committee could prohibit individual acquisitions. In practice CFIUS did little to investigate, let alone block, pending transactions. “The committee almost never met, and when it deliberated it was usually at a fairly low bureaucratic level,” former Reagan administration defense official Richard Perle recalled, describing the process as “a bit of a joke.”

Fears surrounding the national security risks posed by Japanese acquisitions—which culminated with Fujitsu’s attempt to take over the Silicon Valley firm Fairchild Semiconductor in 1987—led Congress to enact the Exon-Florio amendment of 1988. The bill, a revision to the Defense Production Act of 1950, established for the first time a formal foreign investment review process. Under Exon-Florio and an accompanying executive order, the committee was authorized to complete a 30-day review and, when necessary, to conduct an additional 45-day investigation before determining whether to advise the President to block a given transaction. Congress amended the review process again in 1993 by adding the Byrd amendment, which requires a 45-day investigation in all cases where “an entity controlled by or acting on behalf of a foreign government seeks to engage in any merger, acquisition, or takeover of a U.S. entity.” Nevertheless, an absence of significant reviews led CFIUS to drift back into obscurity, where it remained until the following decade.

The state-owned Chinese energy conglomerate CNOOC’s 2005 effort to take over Unocal restored CFIUS’s prominence in the eyes of the public and foreign investors alike. CNOOC made an unsolicited $18.5 billion bid in June 2005—exceeding a competing Chevron offer—that provoked vigorous opposition on Capitol Hill. The House of Representatives passed a resolution stripping the Treasury Department of funds necessary to recommend approval, while the Senate passed an amendment requiring a 30-day review by the Secretary of State to determine whether similar transactions would be

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4 Id. §1(b).


permitted under the laws of an acquiring firm’s country.\textsuperscript{11} Although CNOOC eventually abandoned the deal, it is not clear what the outcome of a full CFIUS review would have been in this case; Secretary of Energy Samuel W. Bodman, for one, acknowledged that the government’s evaluation of the proposed deal would be “truly a complex matter.”\textsuperscript{12}

Controversy over another deal—Dubai-based DP World’s effort to acquire the London firm Peninsular and Oriental Steam Navigation Co. (P&O), which managed six major U.S. ports—erupted less than seven months after CNOOC’s withdrawal. Following several months of consultations, CFIUS approved the acquisition in late 2005 upon receiving specific security-related assurances from DP World.\textsuperscript{13} In mid-February of 2006, the deal began to face sharp criticism from the public and members of Congress, among them several New York and New Jersey representatives hostile to DP World and its control of the Newark port facility.\textsuperscript{14} In response, Congress conducted nearly a dozen hearings, while members introduced a variety of legislation impacting both this transaction and the review process itself.\textsuperscript{15} Seeking to salvage the deal, DP World voluntarily requested in late February that CFIUS initiate a full investigation despite its approval months before, but that step failed to blunt public criticism.\textsuperscript{16} The acquisition finally collapsed on March 9 with DP World’s decision to divest its U.S. holdings, which were later purchased by AIG Global Investments Group.\textsuperscript{17}

Discussion of CFIUS reform continued after the dénouement of the DP World incident, and after more than a year of debate, President George W. Bush signed the Foreign Investment and National Security Act in 2007.\textsuperscript{18} This legislation provides express statutory authority for CFIUS, while expanding the list of factors CFIUS may consider in its evaluations. In addition to those previously recognized, CFIUS now has authority to consider the protection of critical infrastructure and energy resources in its analysis. Perhaps most importantly, the bill reformed congressional oversight of the CFIUS process, providing for greater transparency and imposing briefing and annual reporting requirements. After DP World, the CFIUS process saw an increase in voluntary filings, more 45-day investigations, and more frequent committee requests that parties make security-related commitments pursuant to mitigation agreements.\textsuperscript{19} From the prospective of foreign investors, the review process became more predictable and less politicized, though often more rigorous.

\textsuperscript{13} See id. at 140.
II. FIRSTGOLD MEETS CFIUS

The Firstgold review—thus far, the most noteworthy evaluation conducted by the Obama administration—may be most significant for the glimpse it offers into discussions between committee officials and commercial parties at the time of a transaction’s collapse. Upon learning of an imminent presidential rejection, Firstgold provided what one former CFIUS official described as an “unprecedented release of information,” divulging to the New York Times a memorandum from external legal counsel regarding the CFIUS process. CFIUS’s substantive determination may also prove to be significant; although no evidence exists suggesting that the rejection should be interpreted as part of a broader protectionist shift in U.S. investment policy, the decision—barring further clarification from CFIUS agencies—could further escalate trade tensions. Just as important, this episode serves as a reminder to all foreign investors of the perils they may face if ill-prepared for the CFIUS review process.

In financial terms, Northwest’s acquisition of Firstgold appears insignificant, dwarfed by other CFIUS-reviewed deals valued at billions of dollars. Firstgold’s main mining property consists of the Relief Canyon Mine, an open-pit facility located just over 100 miles northeast of Reno, Nevada. The company had reportedly spent $16 million making improvements to the Relief Canyon facility during the two years preceding the sale, but faced legal action from several creditors by 2009.

Firstgold announced a $26.5 million investment by Northwest, a firm controlled by the Shaanxi provincial government, on July 20, 2009. Under the agreement, Northwest would purchase secured debt—resolving emerging legal disputes with two Firstgold creditors—while also taking a 51 percent stake of outstanding common shares to become Firstgold’s majority shareholder. The parties originally anticipated concluding the transaction by August 31, but in late September Firstgold indicated that it had reached an extension agreement with its creditors, allowing the deal to close as much as two months later. During a November 6 meeting, however, CFIUS officials informed the parties it would be undertaking a full, 45-day investigation pursuant to Section 721(b)(2)–a mandatory step for government-controlled acquisitions, but one that, for reasons that are not clear, appeared to take the parties by surprise.

On December 18, Firstgold went public with news that CFIUS intended to reject the transaction. The primary source of concern among CFIUS officials was the proximity of four mines to the Fallon Naval Air Station. CFIUS officials also suggested the existence of a possible threat to “other sensitive and classified security and military assets that cannot

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24 Firstgold announces new investor, supra note 2.
25 See id.
26 See Firstgold Announces Extension Agreement, supra note 22.
27 Memorandum, supra note 23 at 2.
be identified." Firstgold CEO Terry Lynch expressed disappointment upon learning of the decision, explaining: "While we certainly respect the process CFIUS has taken to arrive at their determination we disagree 100% with their conclusion. We fail to see the connection between [U.S.] national security and our principal asset the Relief Canyon mine which has existed at its present location since the early 1980's." Lynch stressed that the Firstgold property lies more than fifty miles from the Fallon base, and noted that his company’s mine is surrounded by other mining facilities. No further CFIUS action was required, however, as Northwest withdrew from the deal on December 21.

Less revealing than the outcome of this review is the content of Firstgold’s statements and disclosures after learning of CFIUS’s opposition. Most notably, Firstgold chose to release a memorandum, which provides an unprecedented perspective on the committee’s decision-making process. This memorandum, dated December 14, 2009, was written by lawyers at Davis Graham & Stubbs LLP and Reed Smith LLP and submitted to both Firstgold and Northwest ("Memorandum"). Although numbering only five pages, this document included detailed discussions between representatives of the parties and top CFIUS officials, including the committee’s staff chair, Deputy Assistant Secretary for Investment Security Mark Jaskowiak.

Rather than acknowledging CFIUS’s concerns and making a quiet exit from the deal—as parties typically do—Firstgold made clear through this disclosure that the committee had been on the brink of recommending that President Obama exercise his statutory authority and formally block the transaction. As one former USTR and Treasury Department official explained shortly before Northwest’s withdrawal, "[w]hat’s extraordinary here is that these companies might actually force the president himself to do it." The first and only presidential rejection of a CFIUS-reviewed transaction occurred in February 1990, with President George H.W. Bush’s decision to void an acquisition of Boeing supplier MAMCO Manufacturing Inc. by the China National Aero-Technology Import and Export Corporation (CATIC). Although Northwest’s withdrawal eliminated the need for further governmental intervention in this case, the mere specter of a formal presidential rejection has the potential to deter foreign entities from considering mutually advantageous U.S. acquisitions in the future.

Furthermore, not all observers accepted CFIUS’s stated grounds for rejecting this acquisition. In the wake of CFIUS’s decision, some observers maintained that the committee’s resistance was driven in part by concerns regarding Chinese control over gold or other precious metals. An editorial in the Global Times, a Chinese newspaper, attributed the decision to Washington’s "concern over China hoarding gold." Similarly, the chief executive of one Colorado mining firm interpreted the rejection as a message that the United States would more aggressively resist Chinese control over rare earth metals. Indeed, a set of questions that CFIUS had previously submitted to the parties included some inquiries as to what metals other than gold may be mined from the Nevada tracks or exported from the United States.

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29 Memorandum, supra note 23 at 3.
31 See id.
32 See Lipton, supra note 28.
33 U.S. May Block China-Backed Mine Development Near Navy Site, supra note 1.
35 See Lipton, supra note 28.
Despite these suspicions, it appears that CFIUS had little choice but to deny this transaction due to the mines’ unusual proximity to U.S. military facilities. If such concerns were, in fact, the sole source of CFIUS’s opposition, resistance to the deal cannot be easily interpreted as a signal regarding either U.S. investment policy or, more narrowly, its response to Chinese dominance over specific precious metal reserves. Significantly, the Memorandum submitted to Firstgold and Northwest—which appears to have been a confidential, comprehensive summary of discussions with CFIUS—made no mention of such worries. Ultimately, fears that CFIUS officials’ emphasis on military installations disguised the committee’s true purposes remain wholly speculative.

III. ASSESSING THE FIRSTGOLD TRANSACTION IN CONTEXT

Despite this lack of evidence that larger, strategic considerations drove CFIUS’s opposition, it is unquestionable that the Firstgold transaction collapsed at a time of rising international concern about China’s growing control over mineral reserves. In June 2009, the United States submitted a formal request for World Trade Organization (WTO) consultations with China regarding the country’s export restrictions on raw materials. On December 21, 2009—the very same day Northwest announced its withdrawal—the WTO announced that it was establishing a Dispute Resolution Body (DSB) panel to address claims by the United States, European Union, and Mexico challenging the Chinese export regulations. More generally, the Firstgold transaction failed at a moment when U.S.-Chinese economic relations remain on a constructive yet tenuous path. Within the past year alone, the two countries have been engaged in trade disputes ranging from tires to chicken and auto parts to copyright media.

Chinese investors—no doubt, with lingering memories of the CNOOC incident—continue to fear U.S. resistance to acquisitions. The Firstgold/Northwest episode could only rekindle those worries; the critical Global Times editorial argued that CFIUS’s reaction “would hold back many thriving Chinese companies from investing in the attractive but politically dangerous American market,” and warned of a belief “in some quarters that striking down Firstgold investment proposal, although it is small, may deal a blow to China-US relations. It probably will.” Indeed, the CFIUS process remains a blunt

37 See Memorandum, supra note 23.
38 See, e.g., Ariana Eunjung Cha, China Gains Key Assets in Spate of Purchases, WASH. POST, Mar. 17, 2009, at A01 (describing Chinese acquisitions of natural resource assets in such countries as Iran, Brazil, Russia, Venezuela, Australia, and France).
44 See Cha, supra note 38.
45 See Global Times Editorial, supra note 34.
and potentially inflammatory tool with which to influence other countries’ sector-specific policies, given the perceptions of broader protectionism that the rejection of an individual deal can foster.

In addition, Firstgold’s statements indicating that the case was nearly subject to presidential rejection could generate fear that CFIUS will again be unable to offer mitigation arrangements, and become increasingly willing to recommend presidential action. It would be imprudent, however, to read such meaning into CFIUS’s determination in this case. Chairman Jaskowiak unequivocally characterized the transaction as “a very rare and unusual case,” presenting its rejection as “a clear decision that had to be made.”46 In truth, CFIUS’s approach to these unique circumstances—where rejection appears to have been virtually inevitable—may tell parties relatively little about the general functioning of reviews.47 In any event, parties facing future reviews must continue to approach the CFIUS process with a commitment to engagement, and a realistic sense of the committee’s timeline and potential security concerns.

Second, this transaction introduces a new set of confidentiality issues. Here, a party to a friendly takeover chose to disclose substantive discussions, undoubtedly without the committee’s blessing. One former CFIUS official speculated that Firstgold’s release of information may lead the committee to become less forthcoming about its specific security concerns in individual cases.48 Previously, worry about confidentiality in the review process had emanated almost entirely from corporate entities fearing that government officials might misuse or disclose their sensitive, proprietary information. After Firstgold’s revelations, however, CFIUS officials might seek reciprocal assurances from parties regarding the scope of post-investigation statements, if such disclosures are seen as undermining the integrity of the review process.

In the end, although the Obama Administration could not have wanted a case nearly requiring presidential rejection to emerge as its first noteworthy CFIUS review, any adverse fallout can be contained. At a minimum, the Administration would be well-advised to further articulate—to the extent feasible—the reasons behind the rejection, and to continue to assure investors that all acquisitions will be reviewed on their own merits. Nevertheless, thanks to Firstgold’s disclosures, this admittedly small transaction will likely have an outsized effect on foreign investors, as well as on our current understanding of CFIUS.

46 See Memorandum, supra note 23 at 4-5.
47 See id. at 4-5 (indicating that Jaskowiak emphasized on December 14 that it was “very rare and unusual for the only outcome to be a recommendation to prohibit the Transaction”).
48 See Daly, supra note 20.