

Treasury Issues Final Regulations for Foreign Investments Subject to Review by the Committee on Foreign Investment in the United States (CFIUS)

November 17, 2008

INTRODUCTION

On November 14, 2008, the U.S. Department of the Treasury issued a final rule to implement the Foreign Investment and National Security Act of 2007 ("FINSA"), which provided new guidelines for the Committee on Foreign Investment in the United States ("CFIUS") in reviewing investments by foreign persons in U.S. businesses for national security issues. The final rule will become effective thirty days after its publication in the Federal Register.¹

BACKGROUND

As background, the final rule makes changes to the regulations implementing Section 721 of the Defense Production Act of 1950, as amended ("Section 721"), which applies to any transaction involving the acquisition of control by a foreign person over a person engaged in interstate commerce in the United States. Parties to such a transaction may voluntarily notify CFIUS or CFIUS may self-notify. Upon notification, CFIUS must review the transaction to determine the effects on the national security of the United States within 30 days; it may also open a second stage 45-day investigation if it determines the transaction presents a threat to national security that has not yet been mitigated. If CFIUS determines that a transaction would threaten to impair national security, it may negotiate a mitigation agreement or condition, or it may recommend that the President block the transaction or, in the case of a completed transaction, order divestiture.

FINSA requires Treasury to designate one or more lead agencies for each transaction. Subject to certain exceptions, FINSA also requires a second stage 45-day investigation where (1) the transaction threatens to impair national security and that threat has not been mitigated before conclusion of the 30-day review; (2) the transaction is a foreign government-controlled transaction; (3) the transaction would result in foreign control over critical infrastructure that CFIUS determines could impair national security; or (4) the lead agency recommends, and CFIUS concurs, that an investigation be undertaken. In order for CFIUS to conclude action with respect to a foreign government-controlled

¹ Although the proposed and now final regulations are not yet effective, many CFIUS practitioners have been operating as if the proposed regulations were in effect by, for example, including information required by the proposed regulations in voluntary notices submitted to CFIUS.

transaction or a transaction involving critical infrastructure without proceeding to a second stage investigation, Treasury and the lead agency must determine, at the Deputy Secretary level or above, that the transaction will not impair national security.

FINAL RULE PROVISIONS

The final rule made only minor modifications to the rule proposed by the Department of Treasury on April 21, 2008. In particular, the final rule altered new reporting requirements for parties filing voluntary notices with CFIUS to report foreign investments. The proposed rule required any U.S. entity, in its voluntary notice, to report the number of priority rated contracts that it received under the Defense Priorities and Allocations System regulation, and the number that it placed with other entities. The final rule retained that requirement, but limited the reporting period to three years before voluntary notice is filed. Similarly, the proposed rule required a U.S. entity to report its plan to ensure regulatory compliance for priority rated contracts or orders. The final rule retained that requirement, but shifted the reporting burden from the U.S. party to the foreign acquiring party. And where the proposed rule permitted CFIUS to reject a voluntary notice if parties failed to provide follow-up information within two business days of a CFIUS request, the final rule grants parties three business days to comply. Although the three day period is not as long as some had requested in commenting on the proposed rule, we believe it represents a practical recognition by CFIUS of the logistical issues often involved in obtaining information quickly from foreign investors.

The final regulations leave certain controversial FINSA provisions ambiguous: notably, the definitions of foreign government control and critical infrastructure merely restate the text of FINSA with minor changes.² Certain other of the regulations simply formalize existing CFIUS practices such as encouraging advance consultation with CFIUS and requiring personal identifier information for board members and senior executives of the foreign acquirer, as discussed below. However, in some areas, the regulations make significant changes, including clarification of substantive standards and additional requirements for a voluntary notice. Some of the most notable changes include:

- Passive Investment Exception: As before, transactions in which the foreign person acquires 10% or less of the U.S. business solely for the purpose of investment are not subject to Section 721. However, Treasury's discussion of the regulations reemphasizes the importance of the "solely for the purpose of investment" prong, noting that the regulations "do not provide, and have never provided, an exemption based solely on whether an investment is 10 percent or

² FINSA defines a foreign government-controlled transaction as "any covered transaction that could result in the control of any person engaged in interstate commerce in the United States by a foreign government or an entity controlled by or acting on behalf of a foreign government" and critical infrastructure as "systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems or assets would have a debilitating impact on national security."

less in a U.S. business.” A foreign person’s actions, negotiation of special rights, or other factors may show that an acquisition was not solely for the purpose of investment. For example, a transaction involving negotiation of contractual rights that grant the power to control important matters of the U.S. business, or acquisition of the right to appoint a board member, is not solely for the purpose of investment.

- Control: In defining “control,” the regulations include additional factors that indicate control: for example, the ability to appoint or dismiss officers, senior managers, or employees with access to sensitive technology. However, the regulations recognize that certain minority shareholder protections “in themselves” do not confer control over an entity but rather are customary provisions intended to protect the investment. Examples include the power to prevent the sale of substantially all assets of an entity, or the power to purchase additional shares to prevent dilution due to issuance of additional shares. The regulations also include additional examples to help provide guidance as to what constitutes control.
- Advance Consultation: The regulations encourage parties to a transaction to consult with CFIUS in advance of filing a notice and, if necessary, to file a draft notice or other documents. Such advance consultation should occur at least five business days before filing of an official notice and is intended to aid CFIUS’s understanding of the transaction and to provide CFIUS with the opportunity to request additional information to include in the notice (note that this is existing CFIUS “best practices”).
- Civil Penalties: The regulations provide for civil penalties for:
 - Submission of a material misstatement or omission or a false certification, either intentionally or through gross negligence; or
 - Violation of a mitigation agreement or condition, either intentionally or through gross negligence.
- Damages: The regulations also allow mitigation agreements to provide for liquidated or actual damages for breach of the agreement.
- Joint Ventures: Joint ventures are now subject to the same substantive “control” standard as other transactions.
- Hostile Takeovers: In the case of a hostile takeover, if fewer than all parties file a voluntary notice, each notifying party must provide the information with respect to itself and, to the extent known or reasonably available, with respect to each non-notifying party.
- Voluntary Notice Requirements: The voluntary notice filing now requires several additional categories of information. Note, however, that in the past CFIUS has often requested this information in follow-up information requests; the new regulations standardize information

requests across transactions and require more of this information upfront. Major new categories include:

- The names of all financial institutions involved in the transaction, including advisors, underwriters, or sources of financing;
- With respect to the U.S. business that is the subject of the transaction:
 - The estimated U.S. market share for primary product or service lines and lists of competitors;
 - Whether it is the single qualified source or sole source supplier of products or services to agencies of the U.S. government;
 - For the past three years, the number of priority rated contracts or orders under the Defense Priorities and Allocations System regulation that the entity has received, and the number that it has placed with other entities;
 - A description and copy of the entity's cyber security plan;
 - A description of products and technology subject to export authorization administered by the Department of Energy or the Nuclear Regulatory Commission;
 - A description of products covered by certain regulations relating to agents and toxins; and
 - A description of any other licenses, permits, or authorizations granted by an agency of the U.S. government;
- With respect to the foreign person engaged in the transaction and its parents:
 - Whether it has any affirmative or negative rights or powers that could be relevant to whether the transaction is foreign government-controlled; for example, a "golden share," shareholders agreement, contract, statute, or regulation;
 - A description of any formal or informal arrangements among foreign interest holders to act in concert on matters affecting the U.S. business;
 - Biographical information of the members of the board of directors, senior management, and ultimate beneficial owners of 5% or more of the foreign acquirer, its immediate parent, and its ultimate parent;
 - Personal identifier information for members of the board of directors and senior executives of the immediate acquirer and its ultimate parent, any other entities in

the chain of ownership that could exercise control over the U.S. business, and any natural person having an ownership interest of 5% or more of the ultimate parent. This information includes full name, other names and aliases, business address, country and city of residence, date and place of birth, U.S. Social Security number, national identity number, U.S. and foreign passport information, U.S. visa information, and information regarding foreign government and military service;

- Business identifier information for parents of the immediate acquirer and any entities in the chain of ownership that could exercise control over the U.S. business. This information includes business name, and for each branch of the business, address, phone number, fax number, e-mail address, and employer identification number;
- The acquiring party's plan to ensure compliance with the Defense Priorities and Allocations System regulations with regard to any priority rated contracts or orders that the U.S. business has received;
- An organizational chart illustrating entities or individuals above the foreign person up to the persons having ultimate control, including percentage of shares held by each; and
- A position as to whether the acquirer is a foreign person, whether it is controlled by a foreign government, and whether the transaction will result in control of a U.S. business by a foreign person, including the reasons for those views;
- As before, the foreign person party to the transaction, its immediate parent, and the U.S. business that is the subject of the transaction should submit their most recent annual reports. If a U.S. business does not prepare an annual report and its financial results are not consolidated within a parent entity's report, it must submit its most recent audited financial statement.
- Rejection of Notices: The regulations identify several circumstances in which CFIUS may reject a voluntary notice, including:
 - Non-compliance with the filing requirements;
 - Material change in the transaction;
 - Information comes to light that contradicts information in the notice;
 - The parties fail to provide follow-up information within three business days of the request, unless an extension is requested in writing and agreed to; and
 - Failure to submit a final certification.

- Deferred Acceptance of Notices: CFIUS may also defer acceptance of a notice to obtain information required under the regulations that has not been submitted by any parties.

The Firm's Washington, D.C. office regularly counsels clients in connection with the CFIUS review process. For further information about CFIUS and these regulations, please feel free to contact:

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