

INTERNATIONAL TRADE UPDATE

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Treasury Department Issues Proposed Regulations Governing National Security Reviews of Foreign Investments in the United States

On April 21, 2008, the Treasury Department issued proposed regulations under the Foreign Investment and National Security Act of 2007 (FISIA), which reformed the process by which the U.S. government reviews the national security impact of foreign direct investments in the United States. The proposed regulations generally track FISIA, which has now been in effect for six months, and formalize many of the current practices of the Committee on Foreign Investment in the United States (CFIUS), the U.S. interagency committee that leads these national security reviews. The proposed regulations are less onerous than some had predicted, and the initial reaction of the investment community has been positive. Nonetheless, parties to foreign investment transactions should be aware of some of the key changes introduced by these regulations:

- Expanding the range of covered transactions (e.g., transactions involving critical infrastructure) and mandating a second-stage 'investigation' for certain types of transactions involving critical infrastructure or foreign government ownership or control.
- Defining a foreign person's control over a U.S. business to include negative control (i.e., the power to block important decisions, such as the firing of senior executives)
- Clarifying that a foreign person's acquisition of a voting interest of 10 percent or less in a U.S. business does not automatically exempt the transaction from CFIUS review, *unless* that interest is a passive investment (e.g., does not include holding a seat on the U.S. business's board of directors).
- Increasing demands for information, including a requirement that the CFIUS filing include "personal identifier information" (e.g., Social Security Numbers, national identity numbers) for (i) the board members and senior executives of the foreign acquirer, its ultimate parent, and any other entities in the same chain of ownership that could exercise control over the U.S. business being acquired; and (ii) any individual with *an ownership interest of five percent or more* in the ultimate parent of the acquirer.
- Permitting CFIUS to reject a filing if the parties do not provide follow-up information requested by CFIUS within *two business days* of the request, unless CFIUS agrees in writing to a longer timeframe.



Background

On July 26, 2007, President Bush signed FINSA into law, and it became effective on October 24, 2007. The reforms introduced by FINSA, which amended Section 721 of the Defense Production Act of 1950 (50 U.S.C. App. § 2170 *et seq.*), include:^{1/}

- Expanding the range of covered transactions (*e.g.*, transactions involving critical infrastructure) and mandating a second-stage ‘investigation’ for certain types of transactions (*e.g.*, transactions involving an acquirer owned or controlled by a foreign government);
- Authorizing the reconsideration of previously cleared transactions under certain circumstances;
- Increasing congressional oversight; and
- Specifying (i) that CFIUS’s membership would include not only (as before) the heads of the departments of Treasury, Commerce, Defense, State, Justice, and Homeland Security, but also the Secretary of Energy^{2/}; and (ii) that the Secretary of Labor and Director of National Intelligence (DNI) would serve as non-voting, *ex officio* members of the Committee, with the DNI having no policy role other than to provide independent analyses of the national security threats posed by transactions under review.

Is Your Transaction Covered?

The proposed FINSA regulations clarify and potentially expand the types of transactions that CFIUS may review – mainly by revising the definitions of key terms.

- *Control*. Control has always been a threshold concept for CFIUS reviews, and the new definition of control, although revised, is substantively similar to the prior definition. Control “means the power, direct or indirect, whether or not exercised . . . to determine, direct, or decide important matters affecting an entity.” Key aspects of the new proposed definition that are worth noting include:
 - The definition of control continues to avoid bright lines (*e.g.*, a specified percentage of shares owned or board seats held) and maintains a functional approach – the foreign acquirer must exercise actual control, and (at least in theory) mere ‘influence’ is not a sufficient basis on which CFIUS might take action to block or limit the investment.
 - The term control now explicitly covers negative control (*i.e.*, the power to block those important decisions affecting an entity), as well as positive control (*i.e.*, the power to affirmatively make those important decisions). Certain negative rights

^{1/} See our [International Trade Update](#) of July 23, 2007, for an in-depth discussion of FINSA’s key provisions.

^{2/} Under Executive Order 11858, as amended by Executive Order 13456 on January 23, 2008, President Bush also designated as members of CFIUS the U.S. Trade Representative, the Director of the Office of Science and Technology, and the heads of any executive department, agency, or office as the President or the Secretary of the Treasury determines appropriate on a case-by-case-basis.

intended only to protect investment-backed expectations of minority shareholders (e.g., the power to prevent the sale or pledge of *all or substantially all* of the assets of an entity) and that do not affect day-to-day management or strategic decision making, however, do not constitute control.

- The proposed regulations clarify that a foreign person's acquisition of a voting interest of 10 percent or less in a U.S. business does not automatically exempt the transaction from CFIUS review, *unless* that interest is a passive investment (e.g., does not include holding a seat on the U.S. business's board of directors).
- Joint ventures are now explicitly subject to the same control standard as other transactions – the joint venture will only be considered a “covered transaction” if one of the parties contributes a U.S. business and a foreign person gains control over that business by means of the joint venture.
- *Critical technologies.* The proposed regulations define critical technologies to include technology with military applicability as defined by and regulated under U.S. export control, arms control, and nuclear regulations. As noted below, CFIUS notices must now include information about the U.S. business's production or trade in critical technologies.
- *Critical infrastructure.* Critical infrastructure means “systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of the particular systems or assets of the entity would have a debilitating impact on national security.”
- *Foreign government-controlled transaction.* Foreign government-controlled transaction means any covered transaction that could result in the control of a U.S. business by a foreign government or a person controlled by or acting on behalf of a foreign government.

Changes in Timing

The basic process of a CFIUS review remains nearly the same, and CFIUS notices remain voluntary. All cases undergo a 30-day review by CFIUS after receipt of a complete notification of the transaction. At the end of the 30-day period, if CFIUS is unable to conclude that there are no unresolved national security issues, it will move to the second stage – a 45-day investigation. Prior to FINSA, the 45-day investigation, if necessary, was followed by a 15-day period during which the President decided whether to restrict or block the transaction. FINSA somewhat simplified this process by providing that if at the end of the 45-day period, CFIUS unanimously agrees that there are no national security issues or that such issues have been resolved, it may terminate the proceeding. Only if such concerns have not been resolved for all CFIUS member agencies or if CFIUS affirmatively requests that the President make a decision concerning the transaction will the transaction be referred to the President, who has 15 days to decide.

FINSA – and these proposed regulations – also mandate a 45-day investigation under either of two circumstances: (i) the transaction could result in the control of a U.S. business by a foreign government or a person controlled by or acting on behalf of a foreign government; and (ii) the transaction involves critical infrastructure, and CFIUS determines that the acquisition could impair

national security and such impairment has not been appropriately mitigated. These mandatory investigations can be precluded if the Secretary of the Treasury (and the head of the “lead agency,” if one has been designated) certify in writing^{3/} that the transaction will not impair national security.

The proposed FINSA regulations also formalize CFIUS's longstanding practice of encouraging parties to engage in a pre-filing consultation with CFIUS. Such pre-filing consultations involve providing CFIUS with some or all of the information that will be included in the formal notice, preferably a full draft of the filing, and meeting with CFIUS officials.

Finally, the proposed regulations permit CFIUS to reject a filing if the parties do not provide follow-up information requested by CFIUS within two business days of the request or “within a longer timeframe if the parties so request in writing and [CFIUS] grants that request in writing.” This requirement, which is not found in FINSA, should it remain in the final regulations, will prove challenging to transaction parties and, ultimately, to CFIUS.

Increased Demands for Information

The proposed regulations significantly increase the demand for information to be provided in a CFIUS filing. The new information requirements include: (i) the transaction value; (ii) an organization chart of all of the entities or individuals between the immediate foreign acquirer and its ultimate parent; (iii) an indication of whether the parties to the transaction have previously filed a CFIUS notice or are parties to a mitigation agreement; and (iv) information on production or trade in critical technologies.

The proposed regulations now formalize and also expand the requirement that the acquirer provide “personal identifier information” to CFIUS. Such information now must include Social Security Numbers, national identity numbers, and U.S. and foreign passport numbers pertaining to (i) members of the board and senior executives of the foreign acquirer, its ultimate parent, and any other entities in the same chain of ownership that could exercise control over the U.S. business being acquired; and (ii) any natural person with an ownership interest of five percent or more in the ultimate parent of the acquirer. The acquirer now also must provide “business identifier information,” including the business name and address and the employer identification number for all parents of the foreign acquirer and any other entities in the same chain of ownership that could exercise control over the U.S. business being acquired. For privacy reasons and to ensure limited distribution, the “personal identifier information” must be included in a separate document from the filing. The “business identifier information” and “personal identifier information” requirements, in particular, might well raise privacy concerns, and the requirement to identify and provide information regarding persons with an ownership interest of five percent or more in the ultimate parent of the acquirer might prove burdensome for some companies.

^{3/} The authority of the Secretary of the Treasury and the head of the “lead agency” to make this certification may only be delegated to the Deputy Secretary of the Treasury and the deputy head of the “lead agency,” respectively.

Increased Monitoring & Consequences

The proposed regulations bolster CFIUS's monitoring and compliance function in two keys ways. First, for CFIUS notices that are withdrawn prior to the completion of a review or investigation, CFIUS (i) may establish interim protections to address national security concerns with the transaction that arose during the course of the review or investigation; and (ii) may track any actions taken by any party to the transaction before the notice is refiled. Second, to encourage parties' compliance with mitigation agreements, CFIUS may include in a mitigation agreement a liquidated damages or actual damages provision for breaches of the agreement by the parties.

If the parties to the transaction submit false or misleading material information or omit any material information, CFIUS may reopen its review of the transaction and may revise its recommendation to the President. Moreover, the proposed regulations provide for a civil penalty of up to \$250,000 per violation for (i) intentionally or through gross negligence submitting a material misstatement or omission; (ii) making a false certification; or (iii) intentionally or through gross negligence violating a material agreement or condition of a mitigation agreement.

Conclusion

The regulations largely reflect the reforms set forth in FINSA and a continuation of a U.S. policy of publicly supporting foreign direct investment in the United States. They codify and clarify existing informal practices without significantly altering the basic structure of the CFIUS review process or the primary factors to be considered when deciding whether a voluntary CFIUS notification is advisable. Nonetheless, foreign acquirers should consider how the new regulations – both the substance (e.g., the increased emphasis on transactions involving foreign governments and/or critical infrastructure) and the process (e.g., the increased burden imposed by new information requirements) – might affect their acquisition strategies.

The Treasury Department will accept written comments on the proposed FINSA regulations for a period of 45 days, and a public meeting on the proposed regulations will be held on May 2, 2008.

About the International Trade Update

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