

RECENT REFORMS TO U.S. FOREIGN INVESTMENT LAW: *The Foreign Investment and National Security Act of 2007 and Final Regulations*

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To increase “clarity” and “transparency” in the national security review process of certain foreign investments in the United States, the Department of Treasury recently adopted Final Regulations that became effective December 22, 2008.¹ These Final Regulations implement amendments made by the Foreign Investment and National Security Act of 2007 (FINSA).² FINSA and the Final Regulations constitute an important law on foreign investment in the U.S.

FINSA, which became effective October 24, 2007, amended Section 721 of the Defense Production Act of 1950.³ Section 721, (commonly referred to as the Exon-Florio Amendment), authorizes the President of the United States to “suspend or prohibit” any foreign acquisition, merger or takeover of a U.S. corporation that is determined “to threaten the national security of the United States.”⁴

The provisions of Section 721 are carried out by the Committee on Foreign Investment in the United States (CFIUS).⁵ CFIUS, an inter-agency committee chaired by the Secretary of the U.S. Treasury, was originally established by Presidential Executive Order in 1975.⁶ The focus of the CFIUS reviews under FINSA is to “address and identify national security risk posed by covered transactions.”⁷

FINSA statutorily established CFIUS and formalized the process under which CFIUS conducts national security reviews of “covered transactions.” The “covered transactions” subject to CFIUS review are broadly defined by FINSA to include “any merger, acquisition or takeover that is proposed or pending after August 23, 1988, by or with any foreign person which could result in foreign control of any person engaged in interstate commerce in the United States.”⁸

In particular, transactions involving “critical infrastructure” and “critical technologies” are identified by FINSA as matters subject to CFIUS national security review.⁹

FINSA sets forth the actions to be taken by the President, should he find that there is “credible evidence” to support a belief that a foreign person might take action, which threatens to impair U.S. national security.¹⁰ These prescribed protections include suspension or prohibition of such transaction and other appropriate relief, including divestment.¹¹ FINSA further provides increased oversight by Congress, which includes a required annual report of CFIUS reviews and investigations.¹²

FINSA strongly encourages any party or parties to any “covered transaction” to initiate a CFIUS review by voluntarily submitting a written notice of the transaction to the CFIUS Chairperson.¹³ In the alternative, the President or CFIUS may initiate a review.¹⁴

Under FINSA, factors considered for determining whether a transaction affects the national security of the United States, were amended to include:

- the effect on critical infrastructure;
- the effect on critical technologies;
- whether the proposed transaction is a foreign government controlled transaction;
- the adherence of the subject country involved in the transaction to nonproliferation control regimes;
- the relationship of such country in the proposed transaction to the U.S., specifically regarding cooperation in counterterrorism efforts;
- the potential for transshipment or diversion of technologies with military applications; and
- the long-term projection of the U.S. requirements for energy sources and other critical resources.¹⁵

The Final Regulations to FINSA are designed to codify improvements to the CFIUS review process and to provide clarity and transparency to the process with the overall stated goal of supporting international investment “consistent with the protection of national security.”¹⁶

The Final Regulations clarify the definition of a “covered transaction,” by excluding “greenfield” or start-up investments.¹⁷ The triggering definition of “covered transaction” generally excludes long-term leases, and is applied only to certain types of lending transactions and asset acquisitions.¹⁸ A foreign person’s subsequent acquisition of additional interest in a U.S. business, where CFIUS has previously approved the original covered transaction, also does not constitute a new covered transaction subject to additional review.¹⁹

The Final Regulations emphasize the key component of the CFIUS national security review under FINSA as foreign “control.”²⁰ Admittedly, the Final Regulations provide no bright-line test or numerical thresholds for determining whether a transaction results in foreign control, but rather state the test is a functional one.²¹ The form of the transaction and the percentage of shares owned by the entity in question are not determinative of whether control exists.²² Control is generally defined as the “power, direct or indirect, whether or not exercised ... to determine, direct or decide important matters affecting an entity.”²³ Although the Final Regulations do set forth 10 examples of “important matters,” the determination of control is not limited to those factors, but is governed by the general definition.²⁴ In applying this definition, the Final Regulations do exclude ownership interests held or solely acquired for the purpose of passive investment from the CFIUS review process.²⁵

The Final Regulations set forth the framework for the review process, with particular emphasis on encouraging pre-filing consultations by subject entities.²⁶

The Regulations also provide for confidentiality in the exchange of information filed with the Committee, including any materials or information, which was pre-filed prior to the voluntary notice.²⁷ The Final Regulations also set forth timelines for the three phases of review of covered transactions by CFIUS.²⁸ After the filing of a voluntary notice by parties seeking approval of a transaction, CFIUS must complete a review within 30 days to determine whether the proposed transaction is a “covered” transaction.²⁹ The vast majority of transactions require no further review.³⁰ The second stage involving a more intense national security review must be completed within 45 days.³¹

The third and final stage involves review by the President of the U.S. Presidential review occurs

when CFIUS recommends suspension or prohibition of the transaction, is unable to reach a decision, or requests the President to make the decision.³² When a Presidential decision is required, the President must announce his decision within 15 days of completion of the CFIUS investigation.³³ CFIUS reviews rarely reach this stage.³⁴

The Final Regulations also set forth civil penalties, with a maximum of \$250,000 per violation, for material misstatements or omissions to CFIUS made by parties during the review process.³⁵

Notably, neither FINSA nor the Final Regulations provide for a clear definition of “national security.” The omission was intentional. As explained in the “Discussion” section of the Final Regulations, CFIUS “reviews transactions for national security concerns on a case-by-case basis.”³⁶ CFIUS further reasons this approach allows it to “fully address the national security concerns that a particular transaction may raise rather than identifying certain sectors in which foreign investment is prohibited, restricted, or discouraged.”³⁷

For a link to the Final Regulations as well as additional information on CFIUS, go to www.treas.gov/offices/international-affairs/cfius.

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¹ See, “CFIUS Reform: Final Regulations Issued on November 14, 2008” at [http://www.treas.gov/offices/international-affairs/cfius/docs/Summary final Reqs. pdf](http://www.treas.gov/offices/international-affairs/cfius/docs/Summary%20final%20Reqs.pdf)); the Regulations became effective on December 22, 2008.

² “Regulations Pertaining to Mergers, Acquisitions and Takeovers by Foreign Persons, Final Rule”, (“Final Regulations”), 31 C.F.R, Part 800.

³ See, , “CFIUS Reform: Final Regulations Issued on November 14, 2008”

⁴ Section 721 of the Defense Production Act of 1950, as amended by FINSA (2007), 50 U.S.C. App. 2170.

⁵ Id.

⁶ Executive Order 11858 of May 7, 1975, 40 FR20263, 3 C.F.R, 1971-1975.

⁷ “CFIUS Reform: Guidance on National Security Considerations” at [http://www.treasury.gov/offices/international-affairs/cfius/docs/ Guidance Summary](http://www.treasury.gov/offices/international-affairs/cfius/docs/Guidance%20Summary).

⁸ Section 721 of the Defense Production Act of 1950, as amended by FINSA (2007), 50 U.S.C. 2170.

⁹ Id.

¹⁰ Id.

¹¹ Id.

¹² Id.

¹³ Id.

¹⁴ Id.

¹⁵ Id.

¹⁶ “Discussion of Final Rule”, 31 C.F.R Part 800.

¹⁷ Sections 800.301(c) and 800.302(e).

¹⁸ Id., Section 800.303, 31 CF Part 802.

¹⁹ Section 800.204.

²⁰ Id.

²¹ Discussion of Final Rule – Control”, 31 C.F.R Part 800.

²² Id.

²³ Section 800.204, 31 C.F.R Part 800.

²⁴ Section 802.204 lists examples of “important matters” as:

- 1) sale, lease, mortgage, pledge or other transfer of any tangible or intangible prior estate assets;
- 2) reorganization, or acquisition of the entity;
- 3) closing, relocation or substantial alteration of the production, operation or research and development facilities;
- 4) major expenditures or investments, issuance of equity or debt, or dividend payments or approval of the operating budget;
- 5) selection of new business line or ventures;
- 6) the entry into, termination, or non-fulfillment of significant contracts;
- 7) policies or procedures of the entity governing the treatment of non-public technical, financial or other proprietary information;
- 8) the appointment or dismissal of officers of senior managers;
- 9) the appointment or dismissal of employees with access to sensitive technology or classified U.S. government information; or,
- 10) the amendment of the articles of incorporation, constituent agreement, or other organizational documents of the entity with respect to the matters described in paragraph 1 through 9.

²⁵ Section 800.223, 31 C.F.R. Part 800.

²⁶ “Discussion of Final Rule”, 31 C.F.R. Part 800.

²⁷ Section 800.702, 31 C.F.R Part 800.

²⁸ Id.

²⁹ Section 800.502, 31 C.F.R. Part 800.

³⁰ CFIUS Annual Report to Congress-Public version 2008 (96% of reviews were completed at this state in 2007).

³¹ Id., (only 4% of transactions, rendered this stage in 2007).

³² Section 800.506, 31 C.F.R. Part 800.

³³ Id.

³⁴ CFIUS Annual Report to Congress-Public Version 2008(there were no Presidential reviews in 2007)

³⁵ Section 800.801, 31 C.F.R. Part 800.

³⁶ “Discussion of Final Rule”, 31 C.F.R Part 800.

³⁷ Id.