

T O U R F R I E N D S A N D C L I E N T S

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Department of the Treasury Issues Proposed Regulations on National Security Review of Foreign Investments in United States Entities

On April 21, 2008, the US Department of the Treasury issued proposed regulations¹ implementing the Foreign Investment and National Security Act of 2007 (“FINSA”).² FINSA, which was signed into law on July 20, 2007, amended section 721 of the Defense Production Act of 1950, also known as the Exon-Florio law. Pursuant to section 721, the President has the authority to “suspend or prohibit any covered transaction when, in the President’s judgment, there is credible evidence to believe that the foreign person exercising control over a US business might take action that threatens to impair national security.” FINSA, with some significant revisions, codifies the prior structure, practices, and procedures of the Committee on Foreign Investment in the United States (“CFIUS”). CFIUS is an interagency federal committee, chaired by the Secretary of the Treasury, that has been tasked with reviewing, and then allowing, modifying, or making recommendations that the President prohibit, such covered transactions. Consistent with FINSA, the proposed regulations largely track current regulations with some important changes including clarifying that foreign control can be based on negative controls and increasing the scope of information that must be submitted for initial review.

Transactions Open to Review; Covered Transactions

Under FINSA, only “covered transactions” are subject to CFIUS review. FINSA defines the term to include “any merger, acquisition, or takeover proposed or pending after August 23, 1988, by or with a foreign person, which could result in foreign control of a person engaged in interstate commerce in the United States.” The proposed regulations clarify the types of transactions subject to CFIUS review and also provide examples of transactions that would not be deemed covered transactions. For instance, in keeping with the prior regulations, the proposed regulations state that foreign start-up, or “green field” investments, will not be deemed covered transactions.

¹ The proposed regulations were published in the Federal Register on April 23, 2008. See [Regulations Pertaining to Mergers, Acquisitions, and Takeovers by Foreign Persons](#), US Department of the Treasury, 73 Fed. Reg. 21,861 (Apr. 23, 2008).

² Pub. L. No. 110-49, 121 Stat. 246; [amending](#) Defense Production Act of 1950, 50 U.S.C. App. § 2170.

Control

Absent “control” by a foreign entity or person over a U.S. entity, review by CFIUS and Presidential action under the Exon-Florio law, as amended by FINSA, is not authorized. Thus, a key consideration under FINSA and the proposed regulations continues to be the definition of “control.” In keeping with current practice, the proposed regulations state that a determination of control will be made on a case-by-case basis, after examining all relevant material facts. Control is defined in functional terms, focusing on whether the transaction would allow the foreign investor to directly or indirectly “determine, direct, or decide important matters affecting an entity.” It is noteworthy that minority shareholders may be deemed to control despite holding only certain negative controls. Of special note is that the proposed regulations include a non-exclusive list of five protections a minority shareholder may hold that will not, by themselves, be deemed to confer control to that shareholder. Specifically, the foreign (or foreign-controlled) minority shareholder may enjoy the power to:

- prevent the sale or pledge of all or substantially all of the assets of an entity,
- prevent an entity from entering into contracts with majority investors or their affiliates,
- prevent an entity from guaranteeing the obligations of majority investors or their affiliates,
- purchase additional shares to prevent dilution of the shareholder’s pro rata interest, or
- prevent amendments to documents providing the foregoing four protections,

without being deemed to control the US enterprise.

The regulations, as in the past, do not contain a bright-line test in terms of percentage equity ownership or representation on the board of directors. However, the regulations preserve the safe harbor for acquisitions of 10% or less of the US enterprise’s voting securities where the acquisition is made solely for the purpose of investment. The proposed rules also make clear, however, that investments of less than 10% can trigger CFIUS review when the investment is coupled with indicia of control such as the right to a board seat or negative consent rights and that the safe harbor will not apply if the foreign investor has any plan or intention to exercise control over a US business or takes any action inconsistent with acquiring or holding its interest solely for the purpose of investment.

FINSA Implementation

The proposed regulations also reflect FINSA’s requirement for a 45-day “investigation” (subsequent to the initial 30-day “review” period), subject to certain exceptions, where (1) the transaction threatens to impair U.S. national security and that threat has not yet been mitigated; (2) the transaction involves a foreign government-controlled party; (3) the transaction would result in foreign control over critical infrastructure and could impair national security and that impairment has not yet been mitigated; or (4) the lead agency recommends, and CFIUS concurs, that an investigation should be conducted. In general, the proposed regulations do not appear to expand FINSA’s requirements for additional 45-day investigations.

The CFIUS Review Process

Prefiling Contact

The proposed regulations put into writing CFIUS's current practice of encouraging parties to contact the CFIUS staff on an informal basis in advance of filing a formal notice of the transaction with CFIUS. The regulations do not mandate such informal contact. However, the proposed regulations expand the scope of information that must be submitted before a notice filing is considered sufficiently complete for the review process (and the countdown toward any deadlines faced by CFIUS) to commence. Given the increased requirements for information, it may be advantageous for the parties, particularly when the transaction is complex and/or may require significant mitigation, to seek such informal discourse in order to ensure the CFIUS staff has the information they deem necessary so that reviews are completed as quickly as possible.

Formal Notification

Once a notice filing is deemed complete, the CFIUS review process will largely continue to follow current practices. Formal voluntary notice from the parties to the covered transactions is still preferred; however, CFIUS is granted the power to review a transaction of which it has not been so notified. All covered transactions considered by CFIUS will undergo a 30-day review period after receipt of adequate information concerning the proposed transaction. If CFIUS, in accordance with FINSA requirements, is unable to conclude that all national security concerns have been resolved within this time period, an additional 45-day investigation may commence.

Public Comment

The Department of Treasury has invited public comment on the proposed regulations. Comments must be received by June 9, 2008.

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For further information concerning the CFIUS review process, or if you have any questions about the foregoing, please contact your regular Fried Frank attorney or any of the attorneys listed below:

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