

**Final Regulations on Review of Foreign Acquisitions by CFIUS
Issued by the Treasury Department**

December 1, 2008

On November 21, the Treasury Department published its final regulations pursuant to the Foreign Investment and National Security Act of 2007 (FINSA), amending Section 721 of the Defense Production Act of 1950, which authorizes the review of transactions in which a foreign person acquires control of a U.S. business to determine the effects of the transaction on national security, through the Committee on Foreign Investment in the United States (CFIUS). The new final rules, found at 73 Fed. Reg. 70702, provide important guidance as to which transactions are reviewable by the U.S. government and how those reviews will proceed.

The final rules are intended to add clarity and transparency, and thereby efficiency, to the CFIUS review process. Most notably, the regulations seek to clarify the meaning of a “covered transaction,” which is a transaction subject to CFIUS review; clarify when “control”—a prerequisite to a reviewable transaction—is acquired by a foreign person; and elaborate on the review procedures, including an expansion of the types of information formally required in CFIUS filings.

CFIUS has reviewed approximately 10% of all foreign transactions in recent years. As CFIUS has expanded the range of its reviews to encompass acquisitions of critical infrastructure, it is important for those U.S. entities contemplating transactions with foreign investors or purchasers, and for foreign entities contemplating acquisitions or investments in U.S. entities, to make careful assessments of the potential for reviews and clearance by CFIUS.

“Covered Transaction” and Related Terms

A transaction is reviewable by CFIUS if it is a “covered transaction.” The final rules define a covered transaction as “any transaction that is proposed or pending . . . which could result in control of a U.S. business by a foreign person.”

“Transaction” defined—This term includes any transaction that could convey ownership rights in an entity. Notably, the rules specifically include conversions of convertible voting securities, acquisition of proxies, formation of a joint venture, and long-term leases if a lessee makes “substantially all business decisions concerning the operation of the leased entity, as if it were the owner.”

“U.S. Business” defined—A “U.S. business” is an entity that engages in interstate commerce in the United States, including its territories and possessions, even if controlled by a foreign individual or entity. Consequently, the U.S. branch of a foreign corporation is a U.S. business. A foreign corporation that sells to, or has a license with, a U.S. company is not a U.S. business.

“Foreign Person” defined—A “foreign person” is a foreign individual, government, entity, or “any entity over which control is exercised or exercisable by” a foreign individual, government, or entity (emphasis added). A “foreign entity” includes a branch, partnership, group, trust, or corporate division organized under the laws of a foreign state if (1) its principal place of business is outside the United States or (2) its securities are primarily traded on a foreign exchange. If the majority of the entity’s equity is ultimately owned by U.S. nationals, however, the entity is not a foreign entity. A key caveat: an entity can be a U.S. business and a foreign person but not be a foreign entity. An entity might not be a *foreign entity* because, for example, it has its principal place of business in the United States and is not traded on a foreign exchange, but it still might be a *foreign person* because it is controlled by a parent company that is a foreign person.

Examples of Covered and Noncovered Transactions

Covered Transactions	Noncovered Transactions
<ul style="list-style-type: none"> ▪ Transactions that result or could result in a foreign person controlling a U.S. business ▪ Transactions where a foreign person transfers control of a U.S. business to another foreign person ▪ Transactions that result or could result in a foreign person controlling part of an entity or assets, if these constitute a U.S. business ▪ Joint ventures, if a foreign person could control a U.S. business contributed to the joint venture (JV) ▪ Depending on the circumstances, loans or other financing agreements in which a foreign person acquires a profit interest, the right to appoint board members, or other comparable rights, in a U.S. business ▪ Corporate reorganizations where a new foreign person acquires control of a U.S. business even if the ultimate parent of the U.S. business has not changed ▪ Transactions in which a foreign person acquires a majority of the shares in another foreign person, which controls a U.S. business 	<ul style="list-style-type: none"> ▪ Stock splits or prorated dividends without a change of control ▪ Acquisitions of part of an entity or assets, if the part or assets do not constitute a U.S. business (e.g., a “greenfield” investment) ▪ Securities acquisitions by an underwriter in the ordinary course of business and in the process of underwriting ▪ Loans, without more, even if secured (unless and until there is a significant possibility that a foreign person will acquire a U.S. business due to default) ▪ Certain acquisitions of voting interests or assets of a U.S. business upon loan default or similar condition—if the loan was made by a bank syndicate and the foreign person has no or very limited rights of control ▪ Certain acquisitions pursuant to an insurance contract condition if the contract was made by an insurer in the ordinary course of business ▪ If two parties previously notified CFIUS of a covered transaction, and that transaction was cleared by CFIUS, then an acquisition of an additional interest in that same U.S. business by the same foreign person is not a covered transaction.

“Critical Infrastructure” defined—The definition of this term in the proposed rule is retained, with CFIUS continuing not to provide any list or examples of what would be deemed critical infrastructure.

“Passive Investment Exception” defined—Holding or acquiring 10% or less of the outstanding voting interests in a U.S. business, if solely for the purpose of passive investment, is not a covered transaction.

“For the purposes of passive investment” means the acquirer may not a) plan or intend to exercise control, b) have or develop a purpose other than passive investment; and (c) can take no action inconsistent with a passive-investment purpose.

Additional Guidance on the Meaning of “Control”

For a transaction to be considered covered, “control” must be acquired. The final rules elaborate on this definition, list “important matters” that support a finding of control, and provide examples of acquisitions that constitute acquisitions of control.

“Control” defined—Under the final rules, control means “the power, direct or indirect, whether or not exercised, through the ownership of a majority or a dominant minority of the total outstanding voting interests in an entity, board representation, proxy voting, a special share, contractual arrangements, formal or informal agreements to act in concert, or other means, to determine, direct, or decide important matters affecting an entity[.]”

This is not a bright-line test. Rather, the meaning of control is a case-by-case functional assessment that considers all factors relevant to whether a person has effective decision-making power over important business matters. Substance, not transaction structure or form of control, is at the heart of the control test. Simply acquiring *influence* does not mean that *control* has been acquired.

“Important Matters” explained—If an acquisition permits a person to “determine, direct, or take, reach, or cause decisions” regarding “important matters,” this supports a determination that control has been or will be acquired. Such important matters include the following:

- Sale, lease, mortgage, pledge, or other transfer of any principal assets of the entity
- Closing, relocating, or substantially altering production, operation, or R&D facilities
- Issuing equity, debt, or dividend payments, or approving the entity’s budget
- The acquired entity entering, terminating, or failing to fulfill “significant contracts”

Some negative or blocking rights attendant to minority shareholdings do not, in and of themselves, confer control. For example, the power to block the sale of substantially all of an entity’s assets or block contracts with majority shareholders does not necessarily constitute control. The rights excluded from the ambit of “control” are intended to recognize the difference between rights that protect a shareholder’s investment versus rights that enable an investor to affect strategic decisions or business operations.

Filing Procedures and Content

The final rules clarify filing procedures and formally require certain information to be included in the filing, codifying information requirements that CFIUS has already been requesting on a regular basis. Most notably:

- *Prefiling consultation*—CFIUS encourages parties to consult with it and make a prefiling to help CFIUS understand the transaction and identify information that will help the review, thereby making the review as efficient as possible.
- *Request for modification*—The final rules add a provision that allows parties, in “extraordinary cases” and prior to filing, to request CFIUS to modify an information requirement because it is extraordinarily burdensome and modification would not impair the CFIUS review. This provision,

however, will not allow parties to avoid providing personal identifier information and, even if the modification is granted, CFIUS could still request this information during its review, thus potentially leading to delays.

- *Personal identifier information*—Acquiring parties must submit personal identifier information for all directors and officers of the foreign person engaged in the transaction, for all parent companies through the ultimate parent(s), and all 5% or greater shareholders in the foreign person engaged in the transaction and ultimate parent. This information includes date and place of birth, Social Security number (if applicable), U.S. and foreign passport numbers, and dates and nature of foreign government and military service.
- *Competitive information*—An estimate of the U.S. market share of the U.S. business, the methodology used to calculate the share, and a list of direct competitors must be submitted. This will require close coordination with any U.S. or foreign premerger notifications that need to be filed under antitrust laws, to ensure consistency.
- *Certifications*—The requirement in the proposed rules that parties, through high-level officers, certify the accuracy and completeness of the information in the filing was retained in the final rules, which has been CFIUS’s recent practice.
- *Rebranded products or services*—Parties must identify any products or services sold by the U.S. business that are rebranded by the product/service purchaser or incorporated into a third party’s products and, for services, the name of any entities on whose behalf or under whose name the U.S. business provides services.
- *Cyber-security plans*—If the target business has such a plan, a description and copy must be provided. This will require coordination with any previous provision of such plans to other U.S. agencies, such as the Department of Defense and Department of Homeland Security.
- *Rejection of filing*—CFIUS may reject filings if parties do not respond to information requests within three business days, excluding U.S. public holidays.
- *Confidentiality*—The final rules clarify that information and documents provided to CFIUS, including during prenotice consultation, and regardless of whether the filing is later rejected or no filing is submitted, will remain confidential, subject to any later judicial proceedings and Congressional reporting requirements.
- *Penalties*—Parties that intentionally or through gross negligence submit a material misstatement or omission or make a false certification are subject to fines of up to \$250,000 per violation. A party that intentionally or through gross negligence violates a material provision of a mitigation agreement is subject to fines of \$250,000 or the value of the transaction, whichever is greater. Parties that are fined are able to petition for a reconsideration of the fine. CFIUS is authorized to include liquidated damages provisions in mitigation agreements.

The final rules go into effect on December 22, 2008.

If you have any questions about the final rules, or if you would like more information, please contact either of the following Morgan Lewis attorneys:

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