

A WEB CAST

Understanding CIFUS and FINSA

In one of my personal conversation with John B. Connolly, Secretary of the Treasury in President Nixon's administration, he said in 1974 that, when the oil embargo was effectively over, he was dispatched to the Middle East by the President on a fact-finding mission. He reported to the President, among other things, that OPEC members are going to be very rich (the price of oil had gone from 3 to 11 dollars per barrel), and they might be aiming to buy US entities. Such purchases could have an adverse effect on national security. That was when the idea of setting up a commission, obviously headed by the Secretary of the Treasury, to monitor the purchase when a transaction was initiated. However, the actual formation of the commission took place in 1975 during President Ford's presidency through Executive Order number 11858. Exhibit 1.

This Executive Order established a committee called the Committee on Foreign Investment in the United States ("Committee"), which was composed of:

- (1) The Secretary of State
- (2) The Secretary of the Treasury (Chairman)
- (3) The Secretary of Defense
- (4) The Secretary of Commerce
- (5) The United States Trade Representative
- (6) The Chairman of the Council of Economic Advisers
- (7) The Attorney General
- (8) The Director of the Office of Management and Budget

When to file and how it works: Ordinarily, filing ("Notice") is voluntary. Such Notice is given by the company that is involved with a merger & acquisition ("M/A") with a foreign person to a CIFUS officer in the Treasury Department ("Treasury"). However, CIFUS has the authority to request the filing.

Conceivably, CIFUS has certain standards that must be used investigating each case.

How CIFUS addresses National security concerns

First, it evaluates the target American business that the foreign entity intends to buy and merge with. In this evaluation, CIFUS researches the importance of this business in relation to national security. Next, it studies the potential consequences if the transaction goes through. And finally CIFUS studies the possible harmful intent of the foreign entity and its ability to execute such intent.

If CFIUS discovers that the underlying transaction may have an adverse effect on national security, CFIUS reports its finding to the President for a final ruling. But, not all transactions are cut and dry. In many circumstances, CFIUS may introduce mitigating terms and conditions into the transactions. Such measures could involve the US government in supervision, monitoring and limitations.

CFIUS, like all other federal entities, has been expanding in size and regulations. Many more organizations and regulations have been added to it. The regulations governing the CFIUS review process are codified in Code of Federal Regulations. In 2007, the entire regulations (“Regulation”) were revised. However, the public and eventually the Congress of the United States felt that CFIUS has not been doing enough to protect the and passed an act called the Foreign Investment and National Security Act of 2007 (FINSA). Following the September 11, 2001 attacks, the scope of CFIUS reviews expanded to include acquisitions of “critical infrastructure” in the United States. Shortly after, the business community felt that FINSA has gone too far and would prevent the flow of foreign investment into the US. In that atmosphere, the President issued an executive order giving more power to economic agency members of the Committee in the CFIUS process. Furthermore, this issue of infra-structures was codified in (FINSA), which defined critical infrastructure as “systems and assets ... so vital to the United States that the incapacity or destruction of such systems or assets would have a debilitating impact on national security.”

Any Notices filed after that date are subject to Regulations. Regulations also defines what constitutes “Covered Transactions.” It is important to realize that only Covered Transactions are subject to CFIUS review.

Covered Transaction: Any M/A or transaction involving control over a US business is considered Covered Transaction. This definition effectively excludes several types of transactions that could involve foreign entities. Such transactions include but are not limited to long term leases, starting a businesses, lending transactions (not taking over a financial institution), etc.

Committee, in considering the Covered Transaction, looks into the control rather than the concept of the transaction. A mere influence or power of advising is not enough for blocking the transaction.

Timing is of the essence: After a notice is given, CFIUS has a specific time period to perform its function. For example, it has 45 days to review and investigate the Notice and the underlying transaction. Finally, the President has 15 days to make a final ruling. However, in practice things may not go that smoothly and may take a longer time. Furthermore, sometimes even when the Committee and subsequently the President approve a given transaction, the Congress of the United States can eventually such a transaction can be derailed. On the other hand, the president has the legal ability to prohibit or retroactively unwind an investment following a determination that it threatens U.S. national security.

Strict confidentiality: the elements of national security and the business/commercial information are critically important to both sides, business and government. A great deal of effort is made to keep almost all of the material confidential.

Balancing Act: On the surface of it, CFIUS investigations are simple and routine: If anything, even remotely, adversely affects the national security, CFIUS rejects the transaction. However, in reality, the factors determining CFIUS's actions are far from simple. On one side, there are national security concerns. But, nowhere is clearly defined what constitutes a threat to national security: National Defense? High level technology? Access to cyber space? Energy Issues, etc. On the other side is the financial and the business sector. Bringing foreign investors into the US economy has always been a major interest of any administration. As a matter of fact, in the past couple of decades, only a few transactions have been blocked by the President. However, when the Notice file involves either a foreign government or an entity wholly owned by foreign government, the entire processes get a different flavor and is treated with much more care and diligence.