DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
INVESTMENT COMMITTEE

FREEDOM OF INVESTMENT, NATIONAL SECURITY AND "STRATEGIC" INDUSTRIES:
TOUR D'HORIZON OF RECENT DEVELOPMENTS

Answers by the United States to questions posed in document DAF/INV/WD(2008)16

17 December, 2008

This document is for consideration at Roundtable IX on "Freedom of Investment, National Security and 'Strategic' Industries" on December 17, 2008 [under item 3.a. of the draft agenda DAF/INV/A(2008)/4]. In it, the United States answers to questions posed to it in DAF/INV/WD(2008)16.

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1. The US Treasury Department summary states the following: “CFIUS will continue to consider all relevant facts and circumstances, rather than applying a bright-line test to determine whether a transaction results in foreign control”.

- Are there concerns that the open-ended approach to the definition of control will result in less transparency and predictability in the procedure?

- Does the United States believe that there is a trade-off between transparency and predictability (with “bright line” tests making it easier for foreign investors to comprehend where they stand under the law) and the case-by-case approach of CFIUS (which allows policy decisions to be tailored to the circumstances of specific investment proposals?)

**Answer:**

“Control” is a key threshold concept in the Defense Production Act of 1950, as amended by the Foreign Investment and National Security Act of 2007 (“section 721”). The focus on control in section 721 suggests a fundamental congressional judgment that national security risks are potentially highest in transactions that involve the acquisition by a foreign person of control of an entity operating in the United States, although it is important to emphasize that finding that a transaction could result in foreign control of a U.S. business does not mean that the transaction poses national security risk, which involves the assessment of a number of national security considerations. Applying a bright-line definition of control, for example, a certain percentage of ownership or a certain number of board seats, although possibly viewed as more transparent, may not accurately reflect the power of a person to control a company in some cases where such power derives from factors other than the factors that form the basis of the bright-line test. Given the importance of the concept of “control” and the national security interests that CFIUS is mandated to protect, such a bright-line approach could have unintended and unacceptable results.

Instead, CFIUS has defined “control” in a way that requires examination of the specific powers that a foreign person could obtain as a result of the specific transaction. The final regulations provide significant detail in its definition of “control” and establish a standard that, while requiring analysis of all relevant facts and circumstances, is not open-ended. The final regulations define “control,” in part, as:

> “the power, direct or indirect, whether or not exercised, through the ownership of a majority or a dominant minority of the total outstanding voting interest in an entity, board representation, proxy voting, a special share, contractual arrangements, formal or informal arrangements to act in concert, or other means, to determine, direct, or decide important matters affecting an entity .... ”

In addition to the detailed definition itself, the final regulations also provide numerous examples to illustrate application of these rules. As made clear in these examples, it is possible that a person may own
a small percentage of the shares of a company, yet have negotiated rights that give it the ability to
determine, direct, or decide important matters affecting the company. Conversely, and as also made clear
in the examples in the regulations, a person may acquire a significant percentage of the shares of the
company, yet still not have the power to determine, direct, or decide important matters affecting the
company. In such cases, consideration of a fixed shareholding percentage to determine control may not
accurately reflect the actual circumstances of a transaction and, therefore, may be unfair to the parties.

The approach taken by CFIUS, therefore, ties CFIUS’s determination directly to the facts of the
specific case, reflecting attention to another principle identified by the OECD Investment Committee,
proportionality based on all relevant facts and circumstances. The final regulations also provide greater
transparency and predictability by demonstrating the rigor applied by CFIUS in analyzing whether there
is control. The final regulations include detailed illustrative lists of “important matters,” power over
which would confer control, and “minority shareholder protections” that will not be deemed, in
themselves, to confer control.

2. The US Treasury summary states that the final regulations “Define the role of the Secretary of
Labor as advising on whether mitigation terms would violate U.S. employment laws.”

- Could the United States give more information about this potential for inconsistency between
  mitigation terms and US labour law?
- Is there scope for other inconsistencies with other regulations (e.g. securities regulations,
  sectoral regulations)?
- If so, how does the US government intend to handle them?

Answer:

Mitigation terms agreed to by the Committee cannot include provisions that would violate U.S. law,
and must focus solely on mitigating an identifiable risk to national security, and not on broader economic
or national interests, for example, the effect of foreign investment on domestic employment levels.
Nothing in the regulations is intended to suggest that mitigation agreements would be inconsistent with
U.S. laws of any kind. Instead, the provision defining a role for the Secretary of Labor is directly
responsive to Congress’s mandate, in section 721(h)(3)(C), that CFIUS provide an appropriate role for the
Secretary of Labor with respect to mitigation agreements, as an ex officio, non-voting member of CFIUS.
In response to this directive, section 800.508 provides that the Secretary of Labor “shall serve no
policy role” on CFIUS. Instead, the Secretary of Labor’s role is limited to “identify[ing] for the
Committee any risk mitigation provisions proposed to or by the Committee that would violate U.S.
employment laws or require a party to violate U.S. employment laws.” The Committee determined
that this provision defined an appropriate, but limited, role for the Secretary of Labor given his areas
of responsibility.

3. The US Treasury website provides additional information about the way the regulations handle
“the definition of critical infrastructure turns on the national security effects of any incapacity or
destruction of the particular system or asset over which a foreign person would have control as a result of
a covered transaction. Consistent with this approach, the Committee will not deem classes of systems or
assets to be, or not to be, critical infrastructure.”

3
The procedure described in the text has the advantage of not imposing a CFIUS review on noncritical assets just because they are in a particular asset class. A possible disadvantage is that it might be less clear to foreign investors whether their investment projects are subject to a review. How would you suggest that foreign investors handle this? Could they read the US strategy for critical infrastructure protection to try to understand how their investment proposal fits (or does not) with the broader strategy?

Answer:

As noted, CFIUS does not define certain asset classes or sectors as “critical infrastructure” for purposes of section 721. CFIUS takes a more precise approach, consistent with reviewing the effects of the specific transaction on national security, considering whether any incapacity or destruction of the particular system or asset over which a foreign person would have control as a result of the transaction “would have a debilitating impact on national security.” The definition of “critical infrastructure” in section 721 and the final regulations is independent of, and may differ from, the definition of the same term in the context of other laws and reports of the U.S. Government. Such other laws and reports do not necessarily provide appropriate context for understanding the relevance of the term in the CFIUS context.

More generally, the “critical infrastructure” concept in the CFIUS context concerns not whether a transaction will be subject to review—the CFIUS process is a voluntary process—but whether a covered transaction notified to CFIUS presents national security considerations that are relevant for CFIUS to analyze and the level of scrutiny to which the transaction must be subject. Transactions need not involve “critical infrastructure” to raise national security considerations, and transactions that raise “national security considerations” do not necessarily present “national security risks.” CFIUS is authorized under section 721 and the Executive Order 11858 to seek mitigation agreements only where the transaction presents national security risks and, even then, only where other provisions of law are inadequate to address the risks. The guidance that the U.S. Department of the Treasury recently published, on behalf of CFIUS, concerning the types of transactions that CFIUS has reviewed and that have presented national security considerations provides additional insight into how the “critical infrastructure” concept may be relevant to the decision of parties concerning whether to voluntarily notify their transaction to CFIUS.