

DAVIS POLK & WARDWELL

Date: December 10, 2008
To: Interested Persons
Re: CFIUS Guidance Concerning National Security Considerations

Introduction

On December 8, 2008, the United States Treasury Department published [guidance](#) regarding the types of transactions that the Committee on Foreign Investment in the United States (the “Committee” or “CFIUS”) has reviewed that have presented national security considerations (the “Guidance”).¹ The Guidance explains that CFIUS identifies “national security considerations” (*i.e.*, facts and circumstances that have potential national security implications) to assess whether a transaction poses a potential “national security risk.” It emphasizes that “[t]he fact that a transaction presents national security considerations does not mean that CFIUS will necessarily determine that the transaction poses national security risk” because (i) risk requires not only a threat, but also a vulnerability in U.S. security, and (ii) application of laws other than the Exon-Florio statute have often resolved security concerns identified by CFIUS with respect to a particular transaction. The Guidance emphasizes that it does not identify the types of transactions that pose national security risk, and that it should not be used for that purpose.

According to the Guidance, transactions reviewed by the Committee have presented national security considerations that pertain to one or both of (i) the nature of the U.S. business over which foreign control is being acquired, and (ii) the nature of the foreign person acquiring control over a U.S. business.

Nature of the U.S. Business

The Guidance sets forth an illustrative, not comprehensive, description of transactions that have presented national security considerations because they involve U.S. businesses that provide goods or services that “directly or indirectly” contribute to U.S. national security, including transactions that involve:

¹ Section 721 of the Defense Production Act of 1950, as amended by the Foreign Investment and National Security Act of 2007 (“FINSAs”), regulates foreign acquisitions of U.S. businesses that could raise national security risks, and it requires the issuance of the Guidance. Section 721, referred to as the “Exon Florio statute,” does not define “national security,” but instead contains an illustrative list of factors for CFIUS and the President to consider in assessing whether a transaction poses national security risks. The Committee has been designated under FINSAs as the entity responsible for reviewing transactions which could result in control of a U.S. business by a foreign person (“covered transactions”).

- U.S. businesses that could significantly and directly affect the U.S. financial system
- U.S. businesses’ production of certain types of advanced technologies that may be useful in defending, or in seeking to impair, U.S. national security. These U.S. businesses, which may or may not have government contracts, include those engaged in:
 - the design and production of semiconductors and other equipment or components that have both commercial and military applications
 - the production or supply of goods and services involving cryptography, data protection, Internet security, and network intrusion detection
- U.S. businesses that provide products and services, either as prime contractors or as subcontractors or suppliers to prime contractors, to agencies of the U.S. Government and state and local authorities, including:
 - companies with access to classified information
 - companies in the defense, security and national security-related law enforcement sectors
 - businesses related to weapons and munitions manufacturing, aerospace, and radar systems
 - businesses that supply goods and services with broader applicability to a variety of U.S. Government agencies that have functions that are relevant to national security²
- U.S. businesses in the energy sector at various stages of the value chain (*e.g.*, the exploitation and transportation of natural resources)
- U.S. businesses that affect the nation’s transportation system, including maritime shipping and port terminal operations and aviation maintenance, repair, and overhaul
- U.S. critical infrastructure³

² According to CFIUS, such goods and services may involve information technology (consulting, hardware or software), telecommunications, energy, natural resources, or industrial products. They may also include a range of goods and services that affect the national security-relevant functions of the U.S. Government or create vulnerability to sabotage or espionage.

³ “Critical infrastructure is defined in the new CFIUS regulations as “a system or asset, whether physical or virtual, so vital to the United States that the incapacity or destruction of the particular system or asset of the [target] . . . would have a debilitating impact on national security.” 31 C.F.R. § 208. The Guidance notes that the Committee’s determination of whether a transaction involves critical infrastructure is made on a case-by-case basis.

- U.S. businesses that are engaged in the research and development, production, or sale of technology, goods, software, or services that are subject to U.S. export controls

Identity of the Foreign Person

The Guidance notes that certain covered transactions have posed national security considerations because of the track record of the foreign acquirer or its intentions with regard to actions that could impair U.S. national security, including whether the acquirer has plans to terminate contracts between the U.S. business and U.S. Government agencies relevant to national security.

When reviewing foreign government-controlled transactions, the Committee considers all relevant facts and circumstances, including:

- The record of the country of the investor with respect to nonproliferation and other national security-related matters
- The extent to which the basic investment management policies of the investor require investment decisions to be made solely on commercial grounds
- The degree to which, in practice, the investor's management and investment decisions are exercised independently from the controlling government, including whether governance structures are in place to ensure independence
- The degree of transparency and disclosure of the purpose, investment objectives, institutional arrangements, and financial information of the investor
- The degree to which the investor complies with applicable regulatory and disclosure requirements of the countries in which it invests

The Guidance provides that only in exceptional circumstances will a corporate reorganization in which a new foreign person acquires control of a U.S. business (e.g., by becoming an intermediate parent of the U.S. business) raise national security considerations.

If you have any questions regarding this memorandum, please contact either of the lawyers listed below or your regular Davis Polk contact.

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