October 2013

How the U.S. Government Shutdown and Debt Ceiling Could Affect Korean Companies

BY BEHNAM DAYANIM, SCOTT M. FLICKER, HAMILTON LOEB & DEVON WINKLES

Since October 1, the U.S. government has been "shut down" as a result of a funding impasse in Congress. Later this month, unless Congress approves an increase in the federal government's borrowing authority, the country may be unable to pay its outstanding legal obligations. The situation can have significant effects on Korean businesses and financial institutions, including those involved in U.S. litigation or subject to U.S. agency action and owners of U.S. government securities.

Background on the Shutdown and the Debt Ceiling

Each year, Congress is supposed to pass appropriations bills, which finance the U.S. government's discretionary spending programs. However, often, Congress cannot agree on new appropriations bills, so it passes "continuing resolutions," which extend the previous appropriations bills in order to keep the government funded.

On October 1, Congress failed to pass a new continuing resolution, the existing continuing resolution expired, and the government "shut down." This means that discretionary spending programs, which include most federal government spending other than Social Security, Medicare, Medicaid, and interest on debt, are not funded. The law permits only those employees who are either not funded by annual appropriations or who are "excepted," such as those deemed necessary for safety and protection of property, to continue to work, and all others must be furloughed. It is unlawful for those furloughed employees to perform any governmental functions. As a result, approximately one-third of the civilian federal workforce is furloughed, and a wide range of non-exempt government functions have ceased.

Apart from the shutdown, if an agreement is not reached by October 17 to extend government borrowing authority (often referred to as "raising the debt ceiling"), the U.S. Treasury could default on some of its obligations. The debt ceiling is a limit, set by law, on the amount of national debt that can be issued by the U.S. Treasury for the government to meet its existing obligations, such as payments for Social Security and Medicare, military salaries, interest on the national debt and tax refunds. Since 1960, Congress has acted 78 times to raise, temporarily extend, or revise the definition of the debt limit. In the absence of congressional action, the U.S. Treasury takes "extraordinary measures" to avoid default when the debt ceiling is reached. On December 31, 2012, the U.S. reached its debt limit, and various measures have been taken since then to avoid default. However, the Treasury is expected to start running out of funds on October 17 and could default on its obligations going forward. Absent additional government borrowing, experts predict that at some time between October 22 and

November 1, the Treasury will not have sufficient funds on hand to cover all of its daily payment obligations.

Effects on Pending Litigation in U.S. Courts

For now, U.S. federal courts continue to operate. The judiciary has publicly estimated that it possesses funding for approximately 10 business days. On or around October 15, it will provide further guidance. Korean companies with pending litigation before U.S. federal courts should monitor their litigation schedules carefully.

More immediate changes have been made for litigation in which the U.S. is a party. Although criminal litigation has not been affected, U.S. Attorneys have been directed by the Department of Justice to "curtail or postpone" civil litigation "to the extent that this can be done without compromising … the safety of human life or the protection of property." Accordingly, U.S. Attorneys have sought stays in many civil cases. However, not all judges are agreeing to issue the stays. According to the Department of Justice, if a court denies a request to postpone a case and orders it to continue, the litigation will become an excepted activity that can continue during the shutdown.

Importantly, state courts other than the federally-funded D.C. courts are not impacted by the shutdown. Hence, all state litigations continue normally.

Export and Licensing Issues

The shutdown has caused disruptions in agencies that implement many import, export and foreign investment programs in the United States.

Although approximately 6,000 Customs and Border Protection employees are furloughed during the shutdown, inspectors are considered excepted personnel, and imports are expected to continue to enter the U.S. market. However, other agencies involved in importation, such as the Food and Drug Administration, Environmental Protection Agency and United States Department of Agriculture, have furloughed officials with import-related responsibilities and therefore are operating with reduced staffs. A continuation of the shutdown may result in backlogs at these agencies, causing import delays. Those Korean companies that export agricultural and fishery products to the United States should take this factor into consideration when they export their products to the U.S.

Meanwhile, the Department of Commerce has furloughed licensing officers in its Bureau of Industry and Security ("BIS"). As a result, BIS is no longer accepting export license applications, classification requests, encryption reviews, encryption registrations or advisory opinion requests, except for emergency processing of license applications for national security reasons, and its SNAP-R online application is not available. BIS will not be issuing any final determinations, and all pending requests are being held without action. (BIS regulates the export of sensitive goods and dual-use technologies from the United States.)

Similarly, the Treasury Department's Office of Foreign Assets Control ("OFAC") is not processing license applications during the shutdown. (OFAC is responsible for administering U.S. sanctions against Cuba, Iran, Syria, Sudan, North Korea, and other countries and prohibited parties.)

The Directorate of Defense Trade Controls ("DDTC") released a notice stating that it will continue normal operations, although other agencies involved in the review of licenses have limited operations and are only reviewing licenses directly in support of ongoing combat or contingency operations. Because of staffing shortages, requests for commodity jurisdiction determinations may be delayed.

(DDTC is responsible for controlling the export and temporary import of defense articles and defense services covered by the United States Munitions List.)

In addition, the operations of the Committee on Foreign Investment in the United States ("CFIUS") have been suspended during the shutdown. This means that CFIUS will not accept new notices for reviews and likely is not considering pending transactions. It is possible that transactions currently in the review phase will be rolled into a 45-day investigation at the expiration of the 30-day review period or otherwise may be delayed. It has been reported that parties to transactions currently in the investigation phase may receive a letter encouraging them to withdraw their filings voluntarily and re-file once the shutdown ends. (CFIUS is charged with reviewing foreign investments in the U.S. that may raise national security concerns.)

Effects On Owners of U.S. Government Securities

Many Korean financial institutions and even the Korean government own U.S. government securities. Owners of U.S. government securities are unlikely to be directly affected by the shutdown. Interest on debt is not considered discretionary spending and thus is paid regardless of Congress's discretionary appropriations or lack thereof. However, owners of U.S. debt could be affected if the debt ceiling is not raised.

Although opinions are divided, some experts suspect that the Treasury may attempt to prioritize interest payments on U.S. debt, the first of which is due on October 31, over other payments due because missing the interest payments would have a larger effect on the national and global economies than would missing other types of payments. Thus, even if the debt ceiling is not raised prior to the payment due date, the U.S. Treasury may be able to avoid default on its payments to owners of U.S. government securities. However, the strategy of prioritization, if adopted, would only be a temporary solution. Even if it prioritizes interest payments, the Treasury may not have sufficient funds to pay a second interest payment due on November 15. If Congress does not reach a debt agreement, markets are expected to demand higher interest rates to bid on and to hold U.S. debt.

Notably, some policymakers and experts argue that the President has the power, even without action by Congress, to authorize payment of U.S. debt in excess of the debt limit and thereby avoid default. For example, the Senate Finance Committee Chairman, Max Baucus (D-Montana), has advocated that the President consider exercising that power. However, Jay Carney, the White House Press Secretary, recently stated that the Administration does not believe the President has the power to "ignore" the debt ceiling. Thus, it appears that, at least for the moment, the Administration has foreclosed that possibility.

✧ ✧ ✧

If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

Seoul

Jong Han Kim
82.2.6321.3801
jonghankim@paulhastings.com

Washington DC

Behnam Dayanim
1.202.551.1737
bdayanim@paulhastings.com

Scott M. Flicker
1.202.551.1726
scottflicker@paulhastings.com

Hamilton Loeb
1.202.551.1711
hamiltonloeb@paulhastings.com

Ellen Walz Holmes
1.202.551.1834
ellenholmes@paulhastings.com

Devon E. Winkles
1.202.551.1851
devonwinkles@paulhastings.com