

September 29, 2005

GAO Report on Exon-Florio

We are writing to update you on a controversial report, released yesterday by the United States Government's General Accountability Office ("GAO"), assessing the effectiveness of the Committee on Foreign Investment in the United States' ("CFIUS") implementation of the Exon-Florio Amendment to the Defense Production Act ("Exon-Florio"). The GAO undertook to investigate and draft the report in response to recent congressional concerns about the national security review process undertaken by CFIUS, and its conclusions are likely to buttress the congressional critics of Exon-Florio and, in particular, of the leadership of the Department of Treasury, which chairs CFIUS. Among other things, the report concludes:

- Treasury and certain other CFIUS agencies have taken too narrow a view of national security in certain cases.
- CFIUS, with Treasury taking the lead, is reluctant to initiate investigations under Exon-Florio because of a perception that such investigations will chill foreign investment.
- The 30-day timetable for an initial review of a transaction and Treasury's guidelines for complying with that timetable may not afford CFIUS agencies adequate time to assess fully the potential national security implications of particular transactions.
- There is disagreement among the CFIUS member agencies over the criteria to determine when to investigate a transaction, with the Department of Defense and "other officials" arguing for broader criteria that would enable more investigations.

As a result of these and other findings, the GAO has recommended to Congress that it consider amending Exon-Florio to emphasize more clearly the factors that should define national security and further, in order to address the concern over a negative signal for foreign investment, to eliminate the distinction between a review and investigation, thereby making the entire process a 75-day review, with an additional 15 days for the President to make a determination on a particular transaction, if necessary. The report also suggests to Congress that it should re-evaluate the standard for CFIUS to report to Congress and, in particular, should consider requiring CFIUS to provide an annual report on all transactions that occurred within the previous year.

The Treasury Department issued a lengthy response letter to the GAO report, which letter is included in the report as an appendix. Our substantial experience practicing before CFIUS generally comports with many of the points that Treasury has raised in response. In particular, in our view:

- The absence of a firm definition of national security has provided the Executive Branch with sufficient flexibility to protect national security interests. The lack of a precise definition also provides the parties with flexibility to advance positions for why particular transactions do not present problems under Exon-Florio.
- The statutory timeframes provide sufficient time for the agencies to review transactions thoroughly, particularly since most parties presenting a potentially sensitive transaction will vet the transaction with CFIUS before filing for review. The 30-day initial review window also can be an important lever to prompt government engagement. Most transactions reviewed by CFIUS are non-controversial and in no way threaten U.S. national security. Extending the statutory timelines would

put foreign investors at a disadvantage compared to U.S. investors. If fewer foreign investors are competitive bidders for a particular company, the valuation for that U.S. company may be less than it would otherwise.

- The CFIUS process has become more stringent since 9/11, particularly with the addition of the Department of Homeland Security to CFIUS. The mitigation agreements now negotiated by DHS, the Department of Justice, and the Department of Defense, and the level of post-agreement monitoring, are much tougher than prior to 9/11 -- evidence that the way CFIUS views "national security" has broadened since 9/11. In addition, the frequency of investigations is increasing -- there have been six investigations in the last 30 months alone, more than there were in the previous ten years combined.
- We also agree with the important point made by the Department of Justice letter to the GAO that efforts to improve transparency for the CFIUS process should "not in any way impede the current confidentiality afforded to companies that file under the statute." We believe that CFIUS agencies, working with Congress, can find the proper balance between providing Congress with sufficient information to ensure that Congress has confidence in the CFIUS process while protecting sensitive, proprietary company information.

The GAO report, a copy of which is attached, is likely to feed misimpressions of the CFIUS process and could further fan political flames in ways that, in our view, would be detrimental to U.S. investment policy and the interests of both foreign companies seeking to do business in the United States and U.S. companies seeking to do business abroad. We note that a number of foreign countries -- including France, Russia and Canada -- are exploring ways to tighten restrictions on foreign investment. We recommend that domestic clients with business interests abroad and foreign clients with business interests in the United States monitor congressional developments in this space closely and be prepared to engage, either directly or through associations, to ensure U.S. investment review law is not amended in ways that could have negative implications for open investment.

We will continue to keep you apprised of such developments, and would be glad to answer any inquiries on the GAO report or related Exxon-Florio issues.

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This information is not intended as legal advice, which may often turn on specific facts. Readers should seek specific legal advice before acting with regard to the subjects mentioned herein.

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