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THE EXON-FLORIO PROCESS

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I. Background

Section 721 of the Defense Production Act[1] gives the President broad authority to review all "mergers, acquisitions, and takeovers [that] could result in foreign control of persons engaged in interstate commerce in the United States." Following review, the President may block a transaction that the President deems a threat to national security that cannot otherwise be addressed. First enacted in 1988, the provision is more commonly known as the "Exon-Florio" Amendment after its authors, Senator Exon of Nebraska and Congressman Florio of New Jersey.

The statute is administered by the Committee on Foreign Investment in the United States ("CFIUS"), which includes the Secretaries of the Departments of Treasury, State, Defense, Commerce, and Homeland Security, as well as the Attorney General, the United States Trade Representative, the Chairperson of the Council of Economic Advisors, the Director of the Office of Management and Budget, the Director of the Office of Science and Technology Policy, the Assistant to the President for National Security Affairs, and the Assistant to the President for Economic Policy. Other agencies (*e.g.*, Energy, CIA) may be consulted from time to time. The Secretary of the Treasury chairs CFIUS.

The review process involves several steps. Upon receiving notice of a proposed acquisition, CFIUS conducts a 30-day review to determine whether national security considerations warrant a full-scale investigation. If not, the process ends with a notice to the parties that there will be no investigation. But if CFIUS decides that the acquisition presents national security concerns, a 45-day investigation follows, culminating in a recommendation to the President either to block the transaction or let it proceed. The President has 15 days to decide what action to take.

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[1] 50 App. U.S.C.A. § 2170 (West 1991 & Supp. 2006).

II. "Voluntary" Notice

Exon-Florio notice is voluntary, but avoiding CFIUS review can carry significant risk. Acquisitions for which CFIUS does not receive notice remain forever open to executive branch scrutiny and potential divestment. By contrast, once a transaction clears CFIUS review, it may not be reinvestigated unless the initial review was based on incorrect or incomplete information. Moreover, any member of CFIUS can submit notice of a proposed or completed acquisition to CFIUS if the agency believes that the acquisition is subject to Exon-Florio and may have adverse impacts on the national security. Accordingly, even when a transaction is arguably exempt, it is prudent to notify CFIUS in order to vet the transaction.

Discussing the transaction with U.S. government customers is also important, particularly if the case involves facility security clearances or sensitive technologies. Early and full disclosure can help avoid objections and allow time to address export control regulations and regulations governing "foreign ownership, control or influence" of classified government contractors.

III. The Broad Scope of Exon-Florio

A. Who Is a "U.S. Person" and Who Is a "Foreign Person"?

The Exon-Florio regulations define the terms "U.S. person" and "foreign person" to include foreign-foreign and U.S.-U.S. transactions. For example, a U.S. subsidiary of a foreign company can be both a U.S. person and a foreign person. This is because the regulatory definition of a "U.S. person" turns on whether the entity is "engaged in commerce in the U.S.," not on the ownership or place of incorporation of the entity. The regulatory definition of a "foreign person," on the other hand, turns not on where it does business but on whether it is controlled by a foreign interest. The result is that Exon-Florio may apply to the acquisition of a foreign company's U.S. subsidiary by another foreign company. It may also apply to the acquisition of a U.S. company by the U.S. subsidiary of a foreign company.

B. What Constitutes "Control"?

The concept of "control" is broadly defined, and determines both whether an entity is a "foreign" person for the purpose of the statute as well as whether a proposed investment by a foreign person would be subject to the statute. "Control" is defined in functional terms as:

> "the power, direct or indirect, whether or not exercised, and whether or not exercised or exercisable through the ownership of a majority or a dominant minority of the total outstanding voting securities of an issuer, or by proxy voting,

contractual arrangements or other means, to determine, direct or decide matters affecting an entity. . ."[2]

Applying this very broad standard, the determination of who has "control" of an entity turns not merely on the percentage of ownership, but also on who has potential decision-making power. Thus, a minority shareholder with veto power over certain key issues could be considered to "control" an entity for the purpose of Exon-Florio.

C. What Is "National Security"?

Neither the statute nor the regulations define the term "national security," allowing for case-by-case determinations. CFIUS notes that "transactions that involve products, services, and technologies that are important to U.S. national defense requirements will usually be deemed significant with respect to the national security."[3] Notice is therefore appropriate when the target company "provides products or key technologies essential to U.S. defense requirements."[4] CFIUS does not identify essential technologies, products, or services, but some guidance can be gleaned from government lists of essential technologies established for other purposes (for example, the Department of Defense's list of "Militarily Critical Technologies").

The factors enumerated by the statute for consideration by the President in deciding whether to block a transaction are also useful indicators of the issues considered relevant to national security:

- domestic production needed for projected national defense requirements;
- the capability and capacity of domestic industries to meet national defense requirements, including the availability of human resources, products, technology, materials, and other supplies and services;
- the control of domestic industries and commercial activity by foreign citizens as it affects the capability and capacity of the United States to meet the requirements of national security;
- the potential effects of the proposed or pending transaction on sales of military goods, equipment, or technology to any country (1) identified as a country that

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2 31 C.F.R. § 800.204 (2006).

3 56 Fed. Reg. 58775 (1991).

4 Id.

supports terrorism or as a country of concern regarding missile proliferation or chemical and biological weapons proliferation; or (2) listed under section 309(c) of the Nuclear Non-Proliferation Act of 1978 on the "Nuclear Non-Proliferation-Special Country List" or any successor list; and

- the potential effects of the proposed or pending transaction on U.S. international technological leadership in areas affecting U.S. national security.

If asked, CFIUS staff will provide informal guidance on the Exon-Florio process, including whether a given transaction would be deemed to implicate "national security." But the CFIUS process itself is confidential and CFIUS does not publish its decisions. Moreover, prior decisions have no precedential effect.

IV. Special Considerations for Entities Controlled by Foreign Governments

In October 1992, the Exon-Florio provision was amended to require a full 45-day investigation of any case in which an entity "controlled by or acting on behalf of a foreign government" is engaged in an acquisition that could affect national security.[5] Nevertheless, CFIUS retains considerable discretion to determine when a transaction "could affect national security," and the regulations indicate that acquisitions by foreign government-owned entities need not result in formal investigation. The 1992 amendment also flatly prohibits entities controlled by foreign governments from purchasing U.S. companies performing highly classified work for the Department of Defense or the Department of Energy. It also bars foreign government-controlled entities from merging with or purchasing contractors that hold more than $500 million dollars in prime contracts under defense or national security programs. The prohibition does not apply, however, if the acquisition is not suspended or prohibited after Exon-Florio review.[6] In such cases, therefore, Exon-Florio review is essential, and hardly "voluntary."

V. Applicability of Exon-Florio to Joint Ventures

Under the regulations,[7] joint ventures fall within the scope of Exon-Florio if (a) a U.S. person (as defined in the regulations) contributes an existing identifiable U.S. business concern to the joint venture, and (b) a foreign interest would gain control over the business by means of the joint venture.

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5 50 App. U.S.C.A. § 2170(b) (West 1991 & Supp. 2006).

6 50 App. U.S.C.A. § 2170a (West 1991 & Supp. 2006).

7 31 C.F.R. § 800.301(b)(5) (2006).

VI. Conclusion

The Exon-Florio process ensures close scrutiny of foreign acquisitions. Investigations are avoided through careful planning, including structuring the transactions to address national security concerns. In some cases, significant constraints may be required on the foreign owner's oversight and control of the U.S. business. Many deals are therefore quietly withdrawn or re-negotiated in the face of government opposition, often at substantial cost. For all of these reasons, taken together with the heightened concern over U.S. national security at home and abroad, the Exon-Florio process must be considered in connection with any merger, acquisition or joint venture in the defense, national security, or technology industries that involves a foreign investor or partner.

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