PRESIDENT BUSH RESERVES POWER TO WITHDRAW APPROVALS OF FOREIGN INVESTMENT IN THE U.S. ON NATIONAL SECURITY GROUNDS

On November 17, 2006, President Bush, exercising his authority under the Exon-Florio law to reject a transaction in which a foreign entity obtains control of a U.S. business if it threatens to impair U.S. national security, announced that he would not suspend or prohibit the proposed merger of Lucent Technologies, Inc. and Alcatel, a French company. However, in a precedent-setting departure from past practice, the President announced that he was conditioning his approval of the transaction on the execution by Lucent and Alcatel of two national security-related agreements that were being negotiated with the Department of Defense. The President's determination stated that failure to execute the two agreements in a form "materially identical" to agreed-upon draft versions would require that the transaction be rejected on national security grounds. The President also reserved his authority to issue subsequent determinations regarding the transaction that, in his judgment, may be necessary to protect U.S. national security.

These "evergreen" reservations are a significant change in U.S. policy toward foreign direct investment. Under past practice, completion of the review process under the Exon-Florio law was deemed to afford final clearance for such an investment.

Background

Under the so-called Exon-Florio provision of U.S. law (50 App. U.S.C. § 2170(c)), and the implementing regulations (31 C.F.R. § 800.702 et seq.), the President has the authority to accept, reject, or require changes to mergers, acquisitions or takeovers that result in the ownership or control of a U.S. person by a foreign person. The standard by which the President may exercise that authority is based on the potential impact of the proposed transaction on the national security of the United States. If the proposed transaction involves a non-governmental foreign acquirer, then the standard is whether the transaction "will…threaten to impair the national security." If the proposed transaction involves an acquisition by an entity that is controlled by or acting on behalf of a foreign government, the standard is whether the transaction "could affect the national security."

Once the President makes one of the threshold determinations described above, the Exon-Florio provision allows the President to act only if he further determines that there is no other provision of U.S. law that can address the national security concerns raised by the transaction.

The President's determinations are to be made on the basis of an initial review and, if necessary, an additional investigation. The review and investigation are conducted by officials designated by the President to implement the law, consisting of an inter-agency group called the Committee on Foreign Investment in the United States ("CFIUS"), which is led by the Treasury Department and has twelve government agencies as regular members. Parties to transactions subject to the Exon-Florio law may voluntarily notify CFIUS of a proposed transaction, or CFIUS may otherwise become aware of such a transaction. There is no legal requirement to notify CFIUS of

a transaction, and the fact that no such notification may have occurred, or that after a notification a review or investigation may be pending, are not legal impediments to closing a transaction that may be subject to the Exon-Florio law. However, if after the fact CFIUS makes an adverse determination as to national security issues, or a U.S. government agency raises national security concerns about a transaction that had been not notified to CFIUS at all, the status of the U.S. portion of a transaction may be called into question unless those issues or concerns are addressed.

Upon notification or becoming informed by other means, CFIUS has 30 days to conduct an initial review of a proposed transaction. If during that review CFIUS determines that the transaction does not raise national security concerns, the transaction is considered cleared.

If CFIUS determines that there are national security questions that need further review, CFIUS may undertake a formal investigation, which may take up to an additional 45 days. If a transaction involves a foreign person controlled by a foreign government, the additional 45-day investigation is mandatory. Again, as a result of the additional investigation, CFIUS may clear a transaction, request that the parties make changes in the terms of the transaction or indicate that it has serious national security concerns that warrant final review and determination by the President. Presidential review is limited to an additional 15 days, at which time the President must decide whether to approve, request modification of or reject a proposed transaction. Determinations made under Exon-Florio are not reviewable in U.S. courts. A determination at any of these stages not to reject a transaction has, in the past, been considered final unless the parties have provided CFIUS with materially incomplete or false information, in which case a review could be reopened.

Because of Lucent's substantial communications and other technology contracts with state, local and federal government agencies, and the often highly classified work performed by Bell Labs for the Department of Defense and other national security agencies, the Alcatel transaction was subject to the entire CFIUS review and investigation process, during which the parties entered into negotiations with the Department of Defense to obtain approval for Alcatel-Lucent to continue these contracts after the transaction closed, and to provide for continuing U.S. government oversight of the combined entity's U.S. operations.

As a result of the emphasis on national and homeland security since the September 11, 2001 terrorist attacks, and of the controversies surrounding the proposed acquisition of Unocal by the China National Overseas Oil Company ("CNOOC") and the acquisition of P&O Steam Navigation Company ("P&O") by DP World of Dubai ("DP"), such agreements have become more common, and often impose much more far-reaching requirements on parties involved in transactions subject to Exon-Florio review than would earlier have been the case.

Prior to the Alcatel-Lucent review, the enforcement mechanism for these agreements has been specific performance, which contemplates court-imposed penalties for default, coupled with civil and criminal penalties, for violations of laws that impose national security-related restrictions on U.S. businesses. The Alcatel-Lucent transaction is the first in which the U.S. government has reserved the right to reopen the CFIUS process at some later point, and to impose new conditions or even to require that the transaction be unwound, and tied those reservations to signing agreements and complying with those agreements and applicable laws.

This development casts significant doubt on the aspect of the Exon-Florio review process that was considered to be its most beneficial--its finality. Parties in high profile acquisitions of U.S. companies involved in national security sensitive sectors could heretofore rely on successful completion of the CFIUS review process as representing a final determination or clearance with regard to Exon-Florio authority. Unless the U.S. government indicates that these conditions are unique to the Alcatel-Lucent transaction and there is no expectation they will be applied in other situations, this may no longer be the case.

The Alcatel-Lucent determination has raised considerable controversy in the U.S. and international business communities. On December 5, 2006, the U.S. Chamber of Commerce, the Business Roundtable, the Financial Services Forum and the Organization for International Investment wrote to U.S. Treasury Secretary Henry Paulson describing the conditions imposed on Alcatel-Lucent as "a disturbing departure from the government's stated support for an open trade and investment regime." These four organizations, representing a wide range of U.S. multinational companies, stated that "a sanction as significant and fundamental as the ability to unwind a settled transaction is not necessary and undermines other important national interests."

The controversy created by the Alcatel-Lucent determination creates additional pressure for new legislation to amend the Exon-Florio law when the new Congress convenes in January 2007. Such legislation was passed by both the Senate and House in 2006, but the differences between the two versions were not resolved before Congress adjourned. Based on the interest in these bills, it is anticipated that Congress will reconsider these or similar measures in 2007. It seems certain that the business community will ask Congress to include in such legislation a limit on the President's ability to demand "evergreen" authority to reopen and unwind transactions once cleared under Exon-Florio.

Unless and until this question is finally resolved, foreign persons contemplating an acquisition of a U.S. business involved in national or homeland security-related operations should be aware that they could be subject to a new level of continuing uncertainty with respect to U.S. government approval of the transaction.

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If you have any questions regarding this memorandum, please contact Russell L. Smith (202-303-1116, rsmith@willkie.com), or the attorney with whom you regularly work.

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December 22, 2006