

CFIUS

CFIUS tightens its grip on inbound US transactions

BY MARK WILLIAMS



The Committee on Foreign Investment in the United States (CFIUS) was established in 1975, with the primary aim of monitoring and evaluating the impact of foreign investment in the US. In 1988, following attempts by Japan's Fujitsu to acquire Silicon Valley's Fairchild, the Exon-Florio Amendment was enacted as part of the 1988 Omnibus Trade Act. Under the amendment, power was granted to the President to block or suspend certain transactions, and this power was in turn delegated to CFIUS. According to the US Treasury website, the intent of Exon-Florio is not to discourage FDI generally but to act as a review mechanism that could lead to restrictions on FDI that threatens national security. Over the years, CFIUS has analysed transactions involving defence contractors and high technology companies as well as telecoms and internet service providers.

In the last couple of years, two transactions in particular drew the business community's attention to CFIUS and the US stance on national security. The first was CNOOC's proposed acquisition of Unocal in 2005, which would have transferred ownership of a US energy company to China. The second was the 2006 acquisition by Dubai Ports World of P&O, which put several major US ports in Middle Eastern

control. In past years, these transactions would not have drawn particular attention in terms of their impact on national security. The problem, argues John W. Chierichella, a partner at Sheppard, Mullin, Richter & Hampton, LLP, is that the manner in which these deals were ultimately resolved may have inflicted permanent damage on the CFIUS process. "Essentially, Congress expressed a 'vote of no confidence' in CFIUS, intervening to unravel its considered approval of the DPW transaction and to force the withdrawal of the CNOOC bid for Unocal before CFIUS had reviewed the transaction. The process may well have been irretrievably politicised by unnecessary Congressional interference," he says. Both events highlighted the political influence that can be gained by playing on deep-seated fear and suspicion of 'dangerous' countries acquiring US assets and resources. They also unravelled the original intention of Exon-Florio, which was to remove politics from the review process.

Following the terrorist attacks on US soil, the Department of Homeland Security (DHS) was set up and immediately became a member of CFIUS. It is already playing an increasingly important role in determining whether acquisitions can proceed. In the Exon-Florio Amendment,

'national security' was deliberately left as an undefined term so that the provision would remain relevant no matter which direction US foreign policy shifted over time. Following the DPW and CNOOC transactions, the concept of national security has been expanded to include critical infrastructure and homeland security. This focus on 'homeland security' widens the type of deals that could fall under review, including the technology sector, for example, due to data security implications. To address perceived threats, the DHS can impose 'mitigation agreements' on foreign companies, which may include reporting requirements and site visits. "In addition to broadening the scope of transactions subject to review, this expansion has also increased the political sensitivity of the CFIUS review process," says Christopher Wall, a partner at Pillsbury Winthrop Shaw Pittman LLP. "Beyond preparing and filing the notification and working with CFIUS and its member agencies, it is essential to consider the political and public relations aspects of transactions and to develop a government relations strategy to be implemented in connection with the CFIUS review."

Since the review triggers have broadened, CFIUS has taken on more importance for foreign companies considering a US acquisition. Although a CFIUS filing is voluntary, failure to do so may leave a transaction open to future scrutiny and lack of closure. The decision on whether or not to file should form part of the transactional due diligence process. Certain sectors will be more prone to CFIUS review than others. Also, companies from countries that spark US policy concerns will be more susceptible to review than countries with strong diplomatic ties to the US. Due to the simplicity of a CFIUS filing, advisers urge companies not to treat Exon-Florio as an afterthought that might rear up to destabilise a deal down the line.

It is rare, but domestic US companies have been known to provoke CFIUS review and investigation as a way of blocking a potential foreign acquirer or raising its costs, points

out George Foote, a partner at Bracewell and Giuliani. "Even the threat of CFIUS involvement, with the potential of publicising unfavourable information about the foreign acquirer, can discourage the foreign bidder," he says. "The result of such efforts can be to lower the cost of acquisition of the domestic company, with the shareholders of the target being the ultimate losers." But whether a foreign buyer files with CFIUS voluntarily, or has its hand forced by a US target, there are several steps it should take to navigate the review process. First, the company will be working against the clock since the process is unavoidably short. It should therefore establish close and regular contact with CFIUS, responding promptly to any requests for information. Second, it should retain counsel to ensure that all letters, notifications and filings are submitted. Third, effective communications and public relations are crucial. Fourth, contact with the government can be helpful in smoothing progress towards a positive decision on the transaction.

There are dissenters who complain that the Exon-Florio provisions and CFIUS review process are at odds with traditional US economic policies that welcome overseas investment. Yet there are still questions about exactly how much impact CFIUS has had on cross-border M&A into the US. According to Mr Wall, only a handful of the thousands of transactions CFIUS has reviewed since 1988 have been formally investigated and only one

transaction has been blocked, which was the 1992 acquisition of Mamco, an aerospace parts manufacturer by Chinese government agency CATIC. "These statistics, however, do not account for the number of reviews that were withdrawn in which the transactions were restructured and the notification was re-submitted," he says. "Nor does it account for the notifications that were never submitted at all because the parties concluded that CFIUS clearance would not have been possible."

It is apparent that national security concerns will flare up in future transactions with more regularity. Certain amendments to CFIUS legislation that are in the pipeline would indicate a tightening of protocols. Most notably, CFIUS reform bill HR 556 recently passed the House and is on track to be signed by the President. As Mr Foote explains, the new law will formalise some CFIUS practices that have been followed by regulation and practice, and will add more political considerations to CFIUS investigations. "While little of the substance of a CFIUS review will change, the new law will add more bureaucracy to the process and could slow some investments. Congress and the Administration, however, have been clear about their intention not to let the new law extend too far into routine foreign investments and acquisitions," he says. But although US government representatives are labouring to convince international investors otherwise, some commentators have suggested that US protectionist tendencies seem to be closing the

door to foreign investment. Certainly, the new changes encourage more public participation and give rise to greater political pressure on controversial transactions, which could make them more difficult to execute.

The majority of market participants acknowledge the underlying intentions of Exon-Florio and CFIUS, but they want to see these functions utilised appropriately. Observers point to the DPW and CNOOC transactions as the result of unfortunate circumstances, where politics were used to stir up fears of globalisation and foreign opportunism to undermine the existing administration. Sensationalised arguments and political posturing took the issue far beyond the financial dynamic of one company trying to acquire another. "Fortunately, such 'perfect storms' are uncommon," notes Mr Chierichella. "It would obviously be better if the pending Senate bill were to die on the shelf but, even if it were to be enacted, the US has too great an interest in attracting foreign capital to permit the DPW and CNOOC exceptions to become the rule." Only through sensible application of the CFIUS review process will the capital inflow to the US remain a huge contributor to the country's financial and economic wellbeing. Although clearance on Exon-Florio concerns is still achievable, it is arguably more challenging. Foreign companies can improve their chances of deal approval through a measured communication strategy and careful planning in their dealings with CFIUS. ■



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