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## FOCUS

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### FEATURE COMMENT: The Impact Of Foreign Buyers On Mergers And Acquisitions Involving Government Contractors: Foreign Buyers Still Make A Difference, Even In The Absence Of Classified Contracts (Part II)

Last issue, we discussed the extent to which a foreign buyer can introduce an unacceptable level of foreign ownership, control or influence (FOCI) that, absent mitigation, will render the target ineligible for the facility security clearances needed to perform classified work. See 58 GC ¶ 342. In this FEATURE COMMENT, we look at foreign ownership through a broader lens. Specifically, we consider how the U.S. regulates the proposed acquisition of a U.S. business by a foreign interest, irrespective of whether classified contracts and classified information may be involved in the planned transfer.

Since 1988, the evaluation of foreign investments in the U.S. has been conducted under the auspices of the so-called “Exon-Florio” provisions of the Defense Production Act. As implemented, Exon-Florio establishes a process for the “voluntary” submission of information relating to “covered transactions” and a three-step review process that is administered principally by the Committee on Foreign Investment in the United States (CFIUS), an interagency organization created by Executive Order in 1975. CFIUS labored in relative obscurity until Exon-Florio infused it with a critical oversight role regarding trillions of dollars of inbound foreign investment.

In a nutshell, once a voluntary submission of a “covered transaction” is “accepted” by CFIUS:

- CFIUS has 30 days to conduct a review. If CFIUS elects not to conduct an “investigation,” the Exon-Florio process is concluded.
- Any “investigation” that the Committee undertakes must be initiated no later than the end of the initial 30-day review period, and must be concluded within 45 days. All transactions that could result in control of a U.S. business by a foreign government or by someone controlled by, or acting on behalf of, a foreign government will automatically be subjected to the 45-day investigation.
- At the conclusion of the “investigation,” CFIUS can either conclude the matter without action or file a report with the president. The report may provide for any of three outcomes: (1) a recommendation for the suspension or prohibition of the transaction, (2) an inability of the Committee to reach a conclusion, or (3) a request that the president make the determination with respect to the permissibility of whether the transaction is permissible. The president makes any such determination within 15 days of the completion of the investigation.

These timeframes are set forth in the regulations, but they should not be regarded as immutable. CFIUS has the authority to reject a submission or suspend the process for a number of reasons, including the failure of a party making the submission promptly to provide additional information requested by the Committee. If one of the conditions of closing for the deal is the conclusion of the CFIUS process without action, a suspension or rejection of the submission will obviously throw a bucket of “cold water” on the parties’ anticipated closing date.

So far, we have outlined a process and thrown a fair amount of jargon on the table, including “CFIUS” and “covered transaction.” What are these?

As noted above, CFIUS is an interagency organization, each member of which approaches its role in the evaluation of a proposed transaction from its own institutional slant. It is important to recog-

nize this, because any one voting member of CFIUS can trigger a 45-day investigation. The members of CFIUS are:

- The Department of the Treasury, which serves as the chair
- The Department of Justice
- The Department of Homeland Security
- The Department of Commerce
- The Department of Defense
- The Department of State
- The Department of Energy
- The Office of the U.S. Trade Representative
- The Office of Science & Technology Policy

Other offices participate, as appropriate, i.e., the Office of Management and Budget, the Council of Economic Advisors, the National Security Council, the National Economic Council and the Homeland Security Council. *Ex officio* members include the Director of National Intelligence and the Secretary of Labor.

The CFIUS process applies only to covered transactions. Just what are these covered transactions? The regulations identify four categories of such transactions:

- Transactions that result, or could result, in control of a U.S. business by a foreign person;
- Transactions in which a foreign person conveys its control of a U.S. business to another foreign person;
- Transactions that result, or could result, in control by a foreign person of any part of an entity or of assets, if that part of the entity or those assets constitute a U.S. business;
- A joint venture if one or more of the members contributes a U.S. business and a foreign person could control the U.S. business through the joint venture.

Each of the terms is specifically defined in the regulations, and those definitions are accompanied by illustrative examples that, in contrast to many federal regulations, actually do provide useful guidance to buyers and sellers. Among the key elements of some of these defined terms are the following:

- A “transaction” includes not only a merger, consolidation, or acquisition of an ownership interest, but also the acquisition or conversion of convertible voting instruments, the acquisition of voting proxies, the creation of a joint venture, and long term leases under which the lessor makes virtually all of the business decisions concerning operation of the leased business.

- “Control” can be direct or indirect, can be exercised or exercisable, whether through ownership of a majority or dominant minority interest in voting shares, board membership, proxy voting, or contract arrangements, whether formal or informal, to “determine, direct, take, reach, or cause decisions” regarding a host of business decisions, ranging from sale of the business to changes in the production, operational and/or Research & Development facilities of the business, entry into new lines of business, and policy-making regarding the treatment of proprietary information.
- A “U.S. business” is any *entity* (another defined term) engaged in interstate commerce in the United States, irrespective of the nationality of its ownership, “but only to the extent of its activities in interstate commerce.”
- A “foreign person” is a foreign national, a foreign government, or a “*foreign entity*,” which includes any “*entity*” organized under the laws of a foreign state *if either* (a) its principal place of business is outside the United States, *or* (b) its shares are traded primarily on foreign exchanges, *unless* (c) a majority equity interest is “ultimately” owned by *U.S. nationals* (yet another defined term).

Now that we have “clarified” all of this, just what is it about a covered transaction that CFIUS evaluates? Well, the basic purpose of Exon-Florio is to determine whether there is credible evidence that a foreign person exercising control over a U.S. business might take action that threatens the national security of the United States. Not surprisingly, the regulations have never defined “national security, thus affording CFIUS and the president maximum flexibility in evaluating transactions. This flexibility most dramatically manifested itself in the enactment of legislation and the amendment of the CFIUS regulations following 9/11 and the subsequent proposed acquisition in 2006 of P&O Ports (a UK company with operations in U.S. ports) by Dubai Ports World. As a result, the regulations now specifically define and require voluntary submissions to the Committee to include information relating to “*critical technologies*” and “*critical infrastructure*.” The former includes articles and services listed on the U.S. Munitions List found in the International Traffic in Arms Regulations; certain items controlled by the Export Administration Regulations; atomic energy and nuclear energy-related equipment,

parts, software, facilities, and materials; and selected toxins and biological agents. The latter can be “physical or virtual” and would seem to be broad enough to encompass systems and assets such as electrical grids, water systems, and communications networks.

CFIUS is not a pro-business rubber stamp for covered transactions. During the past decade, approximately 40 percent of all submitted transactions have been subjected to a “Step 2” investigation and some seven percent of the submissions have been withdrawn without refile, which is a good indication that the transaction ran into difficulties before the Committee. In 2014—the year for which the most recent data is available—CFIUS required legally binding “mitigation measures” in connection with its disposition of nine (9) transactions, representing six percent of all submittals. In 2012–2014, that percentage was eight percent. In 2009–2014, however, only two of 627 filings resulted in a presidential decision regarding the transaction.

Of covered transactions submitted for CFIUS review from 2012–2014, 68 involved a buyer from China, 45 from the U.K., 37 from Japan, 40 from Canada, and 21 from France. Other double-digit filings originated from Germany (17), the Netherlands, Mexico, and Switzerland (15 each), Singapore (11), and South Korea and Israel (10 each). For 2014, the leading acquirer of “critical technology” companies hailed from the UK (22), with all other nationalities in the single digits (Canada led this group

with nine). The principal focus of these transactions was the Information Technology and Electronics Sectors, with Materials and Semiconductors close on their heels.

**Conclusion**—Successful completion of the CFIUS process allows transactions to close free of the uncertainty that would attend a completed transaction not submitted for Committee review. Under the regulations, if CFIUS advises a party that it has concluded its action with respect to a particular transaction, then the authority of the Committee and/or the President to take action with respect to the transaction “shall not be exercised.” 31 CFR § 800.601(a).

Yes, foreign ownership matters, on many levels, even if classified information is not in issue. And the finality that a successful CFIUS filing provides can put that issue in the rear view mirror.



*This FEATURE COMMENT was written for THE GOVERNMENT CONTRACTOR by John Chierichella and Keith Szeliga, partners in the Washington, D.C. office of global law firm Sheppard Mullin, and members of the firm’s Government Contracts, Investigations and Internal Trade Practice Group. Mr. Szeliga is co-leader of the practice group, and Mr. Chierichella is co-leader of the firm’s Aerospace and Defense Industry team. They can be reached at [jchierichella@sheppardmullin.com](mailto:jchierichella@sheppardmullin.com) and [kszeliga@sheppardmullin.com](mailto:kszeliga@sheppardmullin.com).*