

REPORT

Reproduced with permission from Federal Contracts Report, 96 FCR 46, 07/12/2011. Copyright © 2011 by The Bureau of National Affairs, Inc. (800-372-1033) <http://www.bna.com>

FOREIGN BUYERS' ACQUISITION OF GOVERNMENT CONTRACTORS



BY ROBERT L. BODANSKY AND CAROLINE A. KELLER

Should foreign buyers be reluctant to acquire companies that deal with the United States government? Should prospective sellers, especially those in the defense and intelligence industries, be hesitant to consider foreign buyers for their company? The answer to both questions generally is “no.”

The main concerns of buyers and sellers are that (i) the approval process will result in extended delays and extraordinary expenses, (ii) the process will result in in-

Robert L. Bodansky is a partner in the Washington, DC office of Seyfarth Shaw LLP, emphasizing real estate, business, and investment transactions. Caroline A. Keller is an associate in the Washington, DC office of Seyfarth Shaw LLP, and a member of the Government Contracts Practice Group.

trusive disclosures to, and involvement of, the U.S. government in the transaction and the on-going operations of both buyer and seller, and (iii) after the efforts expended by all concerned to get to a deal, the government will disapprove the transaction. While understandable, these concerns, for the most part, do not appear to be valid.

For sellers, it is important to note that, in addition to being the largest foreign direct investor in the world, the United States is also the largest recipient of foreign direct investment. By the end of 2009, foreign direct investment in the United States totaled \$2.3 trillion.¹ Not surprisingly, there are many foreign companies seeking to acquire federal government contractors. This is particularly true of buyers from the United Kingdom, Western Europe, Canada and Australia. A prudent seller would not want to pass up the opportunities presented by this significant pool of prospective buyers.

Similarly, foreign buyers are keenly aware of the opportunities presented by doing work for the U.S. government. In 2010, the federal government awarded contracts valued in excess of \$536 billion to over 300,000 contractors.² An ever-increasing share of this amount is being paid to foreign companies and their U.S.-based affiliates. Acquiring a government contractor is an attractive way to expand market share, build credibility both inside and outside the U.S., and otherwise gain access to clients and business not otherwise readily available. Buyers need to take a serious look at entering the

¹ See James K. Jackson, *Foreign Investment, CFIUS, and Homeland Security: An Overview*, Congressional Research Service Report for Congress (“CRS Report”), Feb. 4, 2010, at 1.

² See [USAspending.gov](http://www.usaspending.gov), an official website of the U.S. government, http://www.usaspending.gov/explore?fiscal_year=2010&tab=By+Agency&fromfiscal=yes&carryfilters=on&Submit=Go.

U.S. government contract market, and acquiring an existing government contractor is often the quickest and least expensive way to do so.

As a practical matter, what does this mean for buyers and sellers in terms of added regulatory involvement, delay and expense? It means a submission to the government, a modest expense to prepare the submission and have some follow-up with the government, and thirty to sixty days for governmental review (which can run concurrently with preparations for closing the transaction).

If a foreign company is the buyer, an Exon-Florio review is a necessary but fairly routine added part of the transaction. Exon-Florio is the law governing the acquisition of U.S. companies by foreign owners. It covers any "transaction" (merger, acquisition, or takeover) "which could result in foreign control of any person engaged in interstate commerce in the United States."³ Exon-Florio grants the president broad discretionary authority to take "appropriate" action to suspend or prohibit proposed or pending foreign acquisitions, mergers, or takeovers which "threaten to impair the national security."⁴ As a matter of law, the information provided by the disclosing parties during the review process remains confidential and cannot be made public except to the extent relevant in an administrative proceeding or judicial action.⁵

The Exon-Florio process is controlled by the Committee on Foreign Investment in the United States ("CFIUS").⁶ CFIUS was established by an executive order of President Ford in 1975 as an interagency organization that serves the president in overseeing the national security implications of foreign investment in the economy,⁷ and is comprised of representatives from sixteen government agencies and departments including, among others, the Secretaries of the Treasury, Homeland Security, Commerce, Defense and State, as well as the Attorney General.

CFIUS operated in relative obscurity until the implementation of Exon-Florio in 1988. In 2007, in the aftermath of Dubai Ports World, Congress strengthened the CFIUS approval requirements by amending Exon-Florio. Per P.L. 110-49, the Foreign Investment & National Security Act ("FINSAs"), Congress strengthened its role by enhancing its oversight capabilities by requiring greater reporting to Congress by CFIUS on the Committee's actions both during and after it completes reviews and investigations. In addition, Congress fundamentally altered the meaning of "national security" by including critical infrastructure and homeland security as areas of concern comparable to national security.

The parties to a covered transaction begin the process by submitting a voluntary notice to CFIUS (the "submission"). Routine reviews can be completed fairly

quickly, typically within thirty days. In a small number of cases, the process can take additional time. The following briefly summarizes the CFIUS review process:

1. Once the submission is received, a review of the transaction is undertaken by CFIUS. The review is headed by a designated "lead agency" for the transaction.⁸ The CFIUS review must be completed within 30 days once the submission is complete⁹ and typically runs concurrently with various other aspects of the transaction, so any delay is minimal. Most Exon-Florio reviews end at this stage and the parties receive approval to proceed with the transaction.
2. If the proposed buyer is owned or controlled by a foreign government, or if the company's business presents national security concerns or involves "critical infrastructure," a further investigation is required.¹⁰ That investigation can (and usually does) take 45 days from the date it is started.¹¹ On occasion, the government seeks additional time. Note that if a proposed buyer is a foreign government, or is controlled by a foreign government, FINSAs, requires CFIUS to investigate the transaction to determine what, if any, effect the transaction might have on national security.¹²
3. Upon completion of the CFIUS review, the President has 15 days to make a determination as to whether to allow the transaction to move forward. The president is the only officer with the authority to suspend or prohibit mergers, acquisitions, and takeovers, but may only do so if there is credible evidence that a foreign controlling interest might threaten national security and that other legislation cannot provide adequate protection.¹³

Even in situations where the additional investigation is required, the result is usually the same; the transaction is allowed to go forward. However, in a number of these investigation cases, a Special Security Agreement ("SSA") is required. The SSA includes certain agreements or restrictions that screen the foreign owners from information which CFIUS or the President deem vital to national security. It is tailored to the issues presented in each situation, but can include limiting access to information, technology, or facilities, and typically will require a board of directors or other governing body that is primarily composed of independent directors not affiliated with the foreign parent. It also will re-

⁸ 31 C.F.R. § 800.218.

⁹ 31 C.F.R. § 800.502(b).

¹⁰ 31 C.F.R. § 800.503. The term "critical infrastructure" has been defined as "systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction or such systems or assets would have a debilitating impact on national security." 50 App. U.S.C. § 2170(a)(6). The Department of Homeland Security has identified the sectors encompassing "critical infrastructure" to include: (1) Agriculture and Food; (2) Defense Industrial Base; (3) Energy; (4) Public Health and Healthcare; (5) National Monuments and Icons; (6) Banking and Finance; (7) Drinking Water and Treatment Systems; (8) Chemical; (9) Commercial Facilities; (10) Dams; (11) Emergency Services; (12) Commercial Nuclear Reactors, Materials, and Waste; (13) Information Technology; (14) Telecommunications; (15) Postal and Shipping; (16) Transportation Facilities; (17) Government Facilities; (18) Critical Manufacturing. CRS Report at 4.

¹¹ 31 C.F.R. § 800.506(a).

¹² 50 App. U.S.C. § 2170(b)(2).

¹³ 50 App. U.S.C. § 2170(d).

³ 50 App. U.S.C. § 2170(a)(3).

⁴ 50 App. U.S.C. § 2170(d)(1).

⁵ 50 App. U.S.C. § 2170(c).

⁶ 31 C.F.R. § 800.401(a). Although foreign companies contemplating an acquisition that may not have national security implications are not required to notify CFIUS of their intentions, a company that does not do so takes the risk that CFIUS may later determine that the acquisition is a covered transaction for CFIUS purposes, possibly causing the foreign company to have to divest itself of the acquired U.S. company. See 50 U.S.C. App. § 2170(d)(3) (affording the President divestiture as a remedy); 31 C.F.R. § 800.601 (same).

⁷ Executive Order 11858(b), May 7, 1975, 40 F.R. 20263.

quire the appointment of a security officer to administer the SSA. The security officer receives special training and serves as a resource for the company to minimize the chance of a violation of the company's obligations. The obligations and burden under the SSA, including any reporting obligations, are modest. However, if this is the buyer's first time working with an SSA, it may take two or three months after the transaction closes for the common sense requirements of the SSA to become a routine part of the culture and working environment of the company.

If issues arise that cannot be resolved through an SSA, investors sometimes will agree to voluntarily divest certain sensitive assets in the face of pressure from CFIUS, the public, or Congress. In other words, the buyer will acquire the government contractor but may spin-off to U.S. ownership a certain product line or operating division that the government determines is too sensitive to be owned by a foreign company.

Deal breaking issues typically arise only if a foreign government or persons from designated countries (e.g., Iran or North Korea) will control sensitive information, technologies, or infrastructure. Two of the rare but highly publicized transactions which did not result in the transaction going forward, concerned proposed sensitive acquisitions by companies owned by the governments of China and the United Arab Emirates.

In 2005, the Chinese government-owned China National Offshore Oil Corporation (CNOOC) attempted to purchase a large U.S. oil company, raising concerns regarding the national security implications of a Chinese firm acquiring American energy interests. In the face of public sentiment and strong political opposition against the sale expressing concern that the Chinese government (through CNOOC) would exercise undue influence over U.S. energy supplies, CNOOC eventually withdrew its bid.¹⁴ In 2006, CFIUS approved the controversial acquisition by Dubai Ports World (DPW), a company owned by the government of Dubai in the United Arab Emirates, of Peninsular and Oriental Steam Navigation Co. (P&O), a British-owned company that operated six major U.S. ports. After numerous politicians expressed outrage that an Arab government would be responsible for such critical components of the U.S. economy, and Congress' threat of legislation to block the purchase, DPW agreed to voluntarily divest P&O's assets to American Insurance Group.¹⁵ The logic behind these decisions is clear and should not have come as a surprise to those involved.

Similarly, the type of case where CFIUS is likely to be proactive is limited to the unusual case where the governmental concerns are clear. In 2010, CFIUS prevented the Chinese corporation Northwest Non-Ferrous International Investment Company Limited, from investing in U.S. miner Firstgold. Later that year, CFIUS

¹⁴ CNOOC withdraws its bid for Unocal, Asia Times Online, Aug. 2, 2005, available at <http://www.atimes.com/atimes/China/GH04Ad02.html> (last visited June 28, 2011); Jad Mouawad, *Congress Calls for a Review of the Chinese Bid for Unocal*, N.Y. Times, July 27, 2005, available at <http://www.nytimes.com/2005/07/27/business/27cnooc.html?ref=cnoocld> (last visited June 28, 2011).

¹⁵ Jonathan Weisman and Bradley Graham, *Dubai Firm to Sell U.S. Port Operations*, The Washington Post, March 10, 2006, available at <http://www.washingtonpost.com/wp-dyn/content/article/2006/03/09/AR2006030901124.html> (last visited June 28, 2011).

forced another Chinese company, Tangshan Caofeidian Investment Corp., to withdraw its bid for 60 percent of U.S.-based Emcore Corp.'s fiber optics business. With respect to Firstgold, CFIUS determined that national security concerns existed because of the property's proximity—50 miles—to a US. Naval air facility that tests advanced weapons, and Firstgold rejected the mitigation possibilities offered by CFIUS.¹⁶ For Emcore, CFIUS cited only "regulatory concerns."¹⁷ Most recently, in February 2011, Chinese telecom giant Huawei pulled out of a deal to buy bankrupt U.S. server company 3LeafSystems following (i) a recommendation by CFIUS that it divest itself of its newly-acquired assets, and (ii) Congressional opposition citing the security implications of allowing a Chinese company access to telecom and utilities systems.¹⁸

Presidential intervention is even more rare. The President has prohibited only one acquisition since Exon-Florio was enacted in 1988. In 1990, President Bush ordered the China National Aero-Technology Import and Export Corporation (CATIC), a Chinese-government agency, to divest its holdings in MAMCO, a U.S. manufacturer of aircraft components, mainly for Boeing. During the investigation it appeared that CATIC had violated export control laws concerning aircraft engines purchased from General Electric, and there were also concerns that the Chinese government used CATIC as a base for covert operations in the United States.¹⁹

But the instances described above are the exception to the rule. Even faced with Congressional opposition, CFIUS has approved transactions that ultimately go forward. In 2005, for example, CFIUS approved the \$1.7 billion purchase of IBM's personal computer division by Lenovo Group, a Chinese firm, and the \$130 million purchase of Tyco International's fiber-optic cable network by an Indian firm, Videsh Sanchar Nigam (VSNL), despite Congressional concerns that the acquisitions threatened national security.²⁰ However, CFIUS required that VSNL execute an SSA as a condition of approval. The SSA placed certain conditions on the transaction in order to ally the national security concerns raised by the transaction while allowing the deal to close.²¹

¹⁶ CFIUS Finds the Headlines in a Golden Investment Deal, USA Inbound Acquisitions & Investments Blog, available at <http://www.usainbounddeals.com/tags/gold-rush/> (last visited June 28, 2011).

¹⁷ Stewart A. Baker and Stephen R. Heifetz, *Staying Ahead of CFIUS*, The Deal Magazine, Oct. 1, 2010, available at <http://www.thedeal.com/newsweekly/community/industry-insight-1/solving-cfius.php> (last visited June 28, 2011).

¹⁸ Pamela Weaver, *Huawei withdraws from 3Leaf Deal*, Telecoms.com, Feb. 22, 2011, available at <http://www.telecoms.com/24667/huawei-withdraws-from-3leaf-deal/> (last visited June 28, 2011).

¹⁹ Stuart Auerbach, *President Tells China to Sell Seattle Firm*, Wash. Post, Feb. 3, 1990, at A1.

²⁰ Edward Alden, *Senators call for probe of Tyco-Videsh deal*, Financial Times, Apr. 9, 2005, available at <http://www.ft.com/cms/s/0/2fc23a56-a881-11d9-87a9-00000e2511c8.html> (last visited June 28, 2011).

²¹ Mark Plotkin, David Fagan, and Adam Smith, *Steering the Deal Through*, India Business Journal, Sept. 2009, at p.3 available at <http://www.cov.com/files/Publication/5e616f09-55a5-4a1a-97f4-0a3ff6d724cb/Presentation/PublicationAttachment/4c4e9055-65e3-46be-a7ff->

The vast majority of transactions are approved at the initial review stage. Some applications are withdrawn each year, either because the underlying transaction fell through or, based upon preliminary discussions with CFIUS, issues were raised that the buyer could not, or would not address.

It is extremely rare for a matter to go through the complete process and be denied. As the statistics below illustrate, CFIUS routinely approves acquisitions across industries and from a wide range of countries.²²

In the years 2007 through 2009, companies filed 358 notices of transactions that CFIUS determined to be covered transactions. Roughly nine percent (33 cases) of such notices were withdrawn during the review stage and three percent (12 cases) were withdrawn during the investigation stage. Only 15 percent (54 cases) resulted in an investigation. There were no transactions that resulted in a Presidential decision.²³

From 2005 to 2006, there were 175 notices filed, with 15 notices withdrawn during review, 8 investigations, 6 notices withdrawn during investigation, and 2 Presidential decisions (both in 2006 and neither resulting in the President suspending or prohibiting the transaction).²⁴

However, from 1997 through 2004, out of 470 notifications to CFIUS, 451 resulted in acquisitions and

only 8 went to the investigation stage, with the remainder being withdrawn.²⁵

From 1988 through 1994, there were 918 notifications, with only 15 investigations, 5 notices withdrawn, and 1 blocked by the President.²⁶

In short, if a transaction is the “routine” acquisition of a government contractor by a foreign company, there should be little concern about seeking CFIUS approval (unless the company is owned or controlled by a foreign government). A professional well-versed in Exon-Florio submissions and familiar with CFIUS can quickly let you know if there are likely to be any show stoppers or significant hurdles in connection with a given transaction. Do not let the few high profile exceptions deter you from buying a U.S. government contractor or from selling to a foreign company. With a few common sense exceptions, these acquisitions can, and usually do, go through with a minimum of additional effort or expense.

Seyfarth Shaw LLP has a multi-disciplinary team which focuses on Mergers & Acquisitions in the government contractor arena. For more information on this column, or about the Firm’s Multi-Disciplinary Team, or our Government Contracts and Mergers & Acquisitions practices, please contact Robert Bodansky or Caroline Keller or visit www.seyfarth.com.

[13179e90a717/Steering%20the%20Deal%20Through.pdf](http://www.treasury.gov/resource-center/international/foreign-investment/Documents/CFIUS%20Annual%20Report%20to%20Congress%20for%20CY09.pdf) (last visited June 28, 2011).

²² See Committee on Foreign Investment in the United States, Annual Report to Congress, issued November 2010, available at <http://www.treasury.gov/resource-center/international/foreign-investment/Documents/CFIUS%20Annual%20Report%20to%20Congress%20for%20CY09.pdf>.

²³ *Id.*

²⁴ See Committee on Foreign Investment in the United States, Annual Report to Congress, issued December 2008, at 4, available at <http://www.treasury.gov/resource-center/>

[international/foreign-investment/Documents/CFIUS-Annual-Rpt-2008.pdf](http://www.treasury.gov/resource-center/international/foreign-investment/Documents/CFIUS-Annual-Rpt-2008.pdf).

²⁵ U.S. Government Accountability Office, *Defense Trade: Enhancements to the Implementation of Exon-Florio Could Strengthen the Law’s Effectiveness*, GAO 05-686, Sept. 2005, at 14, available at <http://www.gao.gov/new.items/d05686.pdf>.

²⁶ U.S. Government Accountability Office, *Foreign Investment: Implementation of Exon-Florio and Related Amendments*, GAO-NSAID-96-12, Dec. 2005, at 4, available at <http://www.fas.org/asmp/resources/govern/gao9612.pdf>.