

# Implications of National Security Reviews on Foreign Acquisitions of US Businesses

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Contributing Partner

**Ivan A. Schlager**  
Washington, D.C.

Contributing Counsel

**John M. Beahn**  
Washington, D.C.

**Jonathan M. Gafni**  
Washington, D.C.

**Malcolm Tuesley**  
Washington, D.C.

Contributing Associates

**Joshua F. Gruenspecht**  
Washington, D.C.

**John P. Kabealo**  
Washington, D.C.

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Four Times Square  
New York, NY 10036  
212.735.3000

[skadden.com](http://skadden.com)

The Committee on Foreign Investment in the United States (CFIUS) can have a significant impact on transactions involving foreign acquirers. Parties considering cross-border merger and acquisition transactions should be aware of the following recent developments in this area and consider their potential implications.

## Impact of the *Ralls* Decision

In September 2012, on the recommendation of CFIUS, President Obama ordered Ralls Corporation, a Chinese-controlled U.S. company, to divest itself of all interests in four Oregon wind farms that it had acquired in March 2012. Ralls challenged this decision in court, and in July 2014, a panel of the U.S. Court of Appeals for the District of Columbia Circuit ruled that Ralls had not been afforded due process before it was deprived of its property interests. The court decided that Ralls was entitled to review and rebut unclassified information used during the CFIUS process, noting that the president's decision relied on the record developed during that process.

In November 2014, the government provided Ralls with unclassified evidence and factual findings developed during CFIUS' review of the transaction. This unprecedented step may have no effect on the ultimate resolution of the *Ralls* matter, but the appellate court decision and subsequent CFIUS action could affect future transactions and CFIUS reviews in a number of ways:

- Because the court ruled that only the president has the authority to block transactions, CFIUS may decline to seek mitigation terms that have the substantive effect of a block, resulting in either more complex mitigation structures or more referrals of cases for presidential action.
- CFIUS may be more willing to disclose the unclassified information on which it relies in reaching its decisions, giving parties an opportunity to review and possibly rebut that evidence. The production and review of such information, however, may prolong many CFIUS cases.
- CFIUS may collect more information during the review process to bolster the factual record. These supplemental requests also could prolong the CFIUS process.
- The due process rights within CFIUS of parties to transactions are dependent on the existence of property rights. Parties seeking to establish property and due process rights may consider closing transactions before filing with CFIUS. Doing so, however, entails substantive risks; the *Ralls* case and many others have demonstrated that CFIUS' concerns are heightened when parties complete transactions before filing with CFIUS.

## China's Role at CFIUS

CFIUS statistics for 2012 for the first time listed China as the top originator of transactions reviewed by CFIUS. China overtook the United Kingdom, which had been the leading source of CFIUS filings for many years. CFIUS has not yet released statistics for 2013 or 2014, but we believe, based on announced M&A activity and increased Chinese awareness and

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understanding of the CFIUS process, that China remains the leading source of CFIUS-reviewed transactions. We expect this trend to continue in 2015 as China's economic growth slows, leading Chinese investors to seek to diversify their holdings in other countries.

Additionally, more high-profile Chinese acquisitions of U.S. businesses are being approved by CFIUS, giving investors from China greater confidence that prospective U.S. investments will be successful. CFIUS approved several high-profile Chinese acquisitions during 2014, including China Huaxin's acquisition of the enterprise business of Alcatel Lucent and Lenovo's acquisitions of IBM's server business and Google's Motorola Mobility business. Notably, all three of these transactions involved information and communications technology, a sector in which Chinese acquirers have had previous difficulties obtaining CFIUS approval.

## Sanctions Programs

In most cases, CFIUS is concerned that a prospective foreign acquirer has had dealings with a sanctioned country or entity, and that products, technology or funds from an acquired U.S. business might be transferred to the sanctioned country as a result of the acquisition. If the acquirer does not have an effective sanctions compliance program in place, CFIUS may require tighter mitigation terms or seek to prevent the transaction from being completed. It's prudent for prospective acquirers to establish and implement such a plan.

In addition, because the filing requirements listed in the CFIUS regulations do not account for ties between acquirers and sanctioned countries, CFIUS increasingly requests supplemental information from acquirers. This includes details on their dealings, if any, with sanctioned countries and entities, and the trend highlights the need for robust sanctions compliance plans, which can assist in documenting an acquirer's dealings with countries subject to U.S. sanctions, Specially Designated Nationals and Blocked Persons, or other sanctioned entities. (See "[Sectoral Sanctions Add New Layer of Complexity to OFAC Sanctions.](#)")

## Transaction Structure Elements Prospective Acquirers Must Consider

CFIUS has increasingly been presented with foreign acquisitions of businesses with technology and operations relating to U.S. national security and critical infrastructure, including acquisitions originating in China and other traditionally "sensitive" countries. These transactions often present a high risk of CFIUS mitigation, and structuring around such risk has become increasingly critical. Prospective buyers and sellers of sensitive businesses should be aware of the many options available to allocate risk, including standard mitigation covenants or more esoteric options, like reverse termination fees.

Fees paid by acquirers for failure to complete a transaction and/or conditioned on failure to obtain corporate approvals or necessary financing have been part of the deal environment for many years. Recently, failure to obtain U.S. or foreign regulatory approvals — particularly those relating to antitrust laws, but occasionally CFIUS as well — also has been the trigger for payment of breakup fees by acquirers. In September 2014, for example, Germany's

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Siemens agreed to pay US\$400 million — just over 5 percent of the target’s enterprise value — if CFIUS failed to approve the acquisition of oil and gas equipment producer Dresser-Rand. Acquirers considering proposals from sellers that include such fees should carefully assess the mitigation risks associated with a CFIUS review.

Pre-emptive divestitures also may be appropriate in select cases where a U.S. target has defense contracts or other contracts relating to national security, develops or uses sensitive technologies, or has access to sensitive government facilities. A preemptive divestiture of operations connected with national security can be undertaken in an orderly, value-preserving manner, reducing concerns associated with conditions imposed in CFIUS mitigation. This approach first received public attention in late 2012 when A123 Systems, a bankrupt U.S. battery maker, sold its government and defense businesses to a U.S. company before selling the remaining automotive and commercial battery businesses at auction. When China’s Wanxiang Group won the auction for those less sensitive businesses, the companies were able to gain CFIUS approval in early 2013.

These emerging issues are among the many that could have implications for cross-border investment transactions. To enable careful advance planning, it is critical that parties pursuing such transactions during 2015 be prepared to engage in the CFIUS process.