

POLITICAL DUE DILIGENCE AND THE ART OF THE CROSS-BORDER DEAL

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Cross-border transactions are on the rise again, accounting for more than 40 per cent of the \$2.7 trillion in global M&A in 2010. US businesses were the most targeted in 2010 and increasingly the buyers are from emerging economic powers.

But current public and political sentiment in the US can pose challenges for foreign investors. A headline can make or break a deal, and failure to address the political and other perceived risks during the earliest planning stages can jeopardize a transaction and cast a shadow over a company's reputation. In an era of tougher regulation and the politicization of foreign investment, political due diligence can no longer be an afterthought.

In the US, the level of scrutiny applied to foreign transactions has increased dramatically. While economic instability historically tends to feed protectionism, persistent high US unemployment and a highly partisan political environment mean that Washington is acutely sensitive to any transaction that could cost US jobs.

This political radar is all the more alert when it comes to US acquisitions by foreign state-owned firms and sovereign wealth funds. Cross-border deals drew headlines in 2005 and 2006 when two controversial deals were proposed, one by China National Offshore Oil Corp. (CNOOC), one of China's big state oil companies, the other by DP World, a United Arab Emirates-headquartered port operator.

More recently, the difficulties experienced by Chinese telecom equipment maker Huawei underscored the sensitivities in the US. In 2008, Huawei and Bain Capital had to withdraw their bid for 3Com, a US tech firm since acquired by Hewlett-Packard, after it became clear the deal would not be approved by the Committee on Foreign Investment in the United States (CFIUS), a government body that was given full presidential authority in 1988 to conduct national security reviews of foreign investments. Earlier this year, Huawei also was forced to unwind its 2010 acquisition of patents and staff from tech startup 3Leaf Systems after CFIUS retroactively reviewed the transaction. Initially, Huawei had not informed CFIUS of the \$2m deal.

In the current political climate in America, issues such as national security, economic competitiveness, trade policy and job security are hypersensitive. At the same time, however, comments by Obama administration officials show it is open to foreign investment – including acquisitions – as long as the case can be made that it promotes innovation and protects jobs.

Increased government scrutiny

Savvy foreign buyers know that US government scrutiny of foreign investment has increased since 2007, when Congress reformed CFIUS. Chaired by the Treasury, CFIUS now involves at least 15 other federal agencies, including trade, defense and national security representatives, which collectively assess the national security implications of proposed transactions.

The 2007 legislation, passed in the wake of the CNOOC and DP World controversies, streamlined the CFIUS process and gave it more political clout. This included making briefings to Congress

on CFIUS' activities mandatory; requiring top-level official clearance of any vetted transactions; requiring input from both the intelligence and labor agencies; and giving the president broad scope to appoint additional oversight members.

While CFIUS is designed to protect US national security, some constituencies stretch this to include protecting a wide range of US economic interests. CFIUS keeps much of its workings confidential, but its most recent unclassified Annual Report to Congress, released in late 2010, noted that foreign governments are very likely to continue to use various methods to obtain strategic US technologies. This highlights the need for critical thinking at the earliest stages of foreign investment in the US, given the political desire to protect homegrown innovation.

The CFIUS report also underscores the committee's breadth and power. The most striking statistic is the surge in the proportion of deals subject to investigation, and therefore delay: in 2009, 38 per cent of CFIUS deals were subject to a full investigation, up from 14 per cent and 4 per cent in 2008 and 2007, respectively.

So what does this mean for foreign buyers who may have the financial wherewithal to acquire a US target but lack the political intelligence needed to close the transaction?

The answer lies well beyond hiring a good lobbyist, although they are certainly part of the equation. Foreign acquirers, especially if they are state-owned or affiliated, need to do the right work in advance to ensure they have identified potential friends and foes and know how to engage with them.

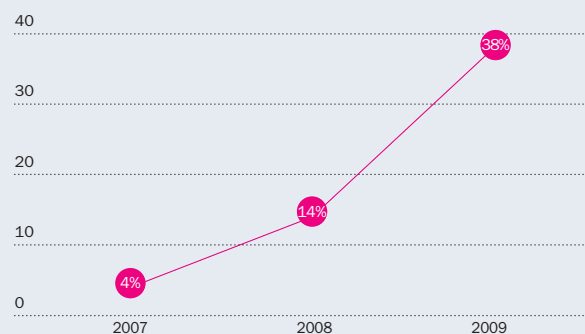
This isn't simply a matter of tallying up lists of names. Would-be buyers must be attuned to the political and policy dynamics of a proposed deal, which could intersect with issues such as national security, competition, corporate governance, fair trade and employment. Companies must shape the messages associated with their transaction accordingly and prepare for political opposition, even while seeking to prevent a firestorm in the first place.

Finally, as some buyers have learned at a cost, staying quiet won't keep you out of the news. Unwillingness to engage can be the liability that kills a deal. ☹

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Surge in investigations

The proportion of foreign deals subject to full US government investigation has soared since 2007 law increased scrutiny.



Source: 2010 CFIUS Annual Report