

# ABA JOURNAL

THE NATIONAL PULSE

## Overseas Oversight

Sovereign investment boom keeps lawyers busy with more complex compliance

BY DEBORAH L. COHEN

**W**HERE THE WORLD economy goes, American law firms follow. These days, much of the action in global finance is coming from oil-rich and developing countries in Asia and the Middle East that are pouring their bountiful equities into U.S. and Western European businesses. (See “Going for Gold in the Gulf,” February, page 18; and “Wise in the Ways of the World,” June, page 16.)

Sovereign wealth funds, state-run investment arms now flourishing in the Middle East, are bloated with reserves from oil wealth and industry. SWFs control an estimated \$3 trillion in investments and are projected to be worth five times as much in 10 years, according to the International Monetary Fund.

In burgeoning economies such as China, large state-backed companies have been scrambling to take advantage of the cheap U.S. dollar by attempting to acquire U.S. concerns such as energy corporations and investment banks.

As those state-run funds keep purchasing stakes in Western businesses, officials in the United States and the European Union worry about the national security risks of buyers so closely tied to foreign governments—especially in the aftermath of the Sept. 11 terrorism attacks in the U.S. and similar attacks in Europe.

Those concerns prompted Congress last year to expand and fortify the Committee on Foreign Investment in the United States—an interagency panel that reviews foreign investment and national security implications. And that, in turn, has fueled a surge in



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compliance work for law practices specializing in foreign investment.

Sept. 11 changed the process “from an obscure activity frequently associated with defense to a multi-industry, multisector focus,” says Mark E. Plotkin, a Washington, D.C.-based partner at Covington & Burling who runs the firm’s foreign investment compliance practice.

Paul O. Gagnier, a partner with the D.C. office of Bingham McCutchen who specializes in telecommunications deals, says roughly a fourth of his time is spent on such compliance work, compared with just 5 percent five years ago.

“Today, savvy acquirers think about this stuff up front and engage national security counsel earlier in the game,” says Gagnier. “The worst thing is not to think about it at all, sign a merger agreement and have to play catch-up.”

The CFIUS process was established in 1975 to assess the risks of foreign acquisitions to national security. In 1988, President Reagan brought the panel under presidential oversight.

CFIUS was at first primarily concerned with defense-related transactions, such as a foreign buyer attempting to acquire a stake in a U.S. conglomerate with a weapons subsidiary.

But CFIUS, which is chaired by the Treasury Department, now includes representatives from 12 agencies, among them the departments of State, Defense and Commerce. In February 2003, the Department of Homeland Security was given a seat.

Last October, Congress passed the Foreign Investment and National Security Act, which added Energy and Labor department representatives to CFIUS and mandated the designation of a lead agency

for each covered transaction. FINSA also broadened the definition of “critical infrastructure deals” that would fall under CFIUS review. The committee now reviews investments in a variety of industries, including those concerned with telecommunications, transportation networks and cyber security.

Legislation similar to FINSA is also being considered in parts of Western Europe. Late last year, for instance, the German government introduced a proposal to amend the German Foreign Trade Act to establish a control mechanism to restrict the influence of foreign investors.

### A TURNING POINT

AFTER 9/11, THE FIRST TRANSACTION that raised security concerns was an aborted deal to buy Global Crossing, the U.S. telecom giant that filed for bankruptcy in early 2002. Global Crossing filed a letter of intent to sell control to a joint venture of Hong Kong-based Hutchison Whampoa and Singapore Technologies Telemedia.

CFIUS made clear it would not give the deal the green light and Hutchison Whampoa withdrew its bid. In 2003, Singapore Technologies purchased the company on its own out of bankruptcy.

“It was a turning point because up to that point, foreign investment in telecoms had been kind of sleepy,” says Plotkin, who represented Global Crossing. “You had a real concern within CFIUS. There was an entirely new view.”

In June 2005, the state-backed Chinese conglomerate China National Offshore Oil Corp. bid \$18.5 billion for the American oil company Unocal. But the deal was killed by bipartisan opposition in Congress, partly due to concerns over national security. Despite the Chinese firm’s willingness to submit to a CFIUS review, Unocal was ultimately purchased by rival bidder Chevron.

Then in March 2006, Dubai Ports World—a holding company owned by the government of Dubai in the United Arab Emirates—acquired U.K.-based Peninsular & Oriental Steam Navigation Co. in a highly publicized deal valued at about \$7 billion.

Because Peninsular & Oriental operated ports in U.S. cities such as New York and Miami, it came under CFIUS review. Despite the committee’s nod of approval, Congress latched on to the issue. Worried over the UAE’s reported financial links to the al-Qaida terrorist network, it publicly questioned the review process. DP World responded by divesting its U.S. port holdings, but politicians on both sides of the aisle remained dissatisfied. The controversy led to the passage of FINSA.

The genie of congressional intervention was let out of the bottle,” says George Kleinfeld, who specializes in CFIUS work as counsel in the Washington, D.C., office of Clifford Chance. “You now have to deal at a political level as well as a security level—making sure people regarded as stakeholders in Congress feel that you’re respecting them by informing them of your plan.”

### LENGHTIER REVIEWS, NEW REGULATIONS

REVIEWS THEMSELVES HAVE BECOME LONGER AND MITIGATION agreements negotiated as a condition for approval

have grown, according to David Marchick, a managing partner with the Carlyle Group, a D.C.-based global private equity firm. Marchick, a former CFIUS attorney with Covington & Burling and an ex-member of the Clinton administration, co-authored the book *U.S. National Security and Foreign Direct Investment*.

Filings rose dramatically in the wake of DP World, according to a January 2007 study Marchick conducted for the National Foundation for American Policy, a nonpartisan public policy research group.

In 2006, those filings numbered 113, up 73 percent from the year before, the study found.

“The more politicized environment surrounding CFIUS has created uncertainty for companies as to whether they should file a transaction with CFIUS,” the report states. “If a company does not file, then it risks CFIUS initiating its own review or opening a review after a deal has been finalized.”

To help codify the process, the Treasury Department introduced a new set of regulations in April that will lend clarity to the procedures. They include guidelines allowing greater interaction between law firms and the committee prior to a notice being filed, as well as clear definitions as to what exactly constitutes a controlling stake by a foreign acquirer—an issue at the heart of CFIUS concern. A controlling stake gives the buyer certain privileges, such as voting rights or influence over management, compared to a passive investment, which is strictly hands-off.

“The proposed regulations increase clarity and make additional improvements based on experience,” said the Treasury Department’s Clay Lowery, assistant secretary for international affairs, in a statement when the proposed regulations were released.

Nancy McLernon, senior vice president for the Organization for International Investment, which represents U.S. subsidiaries of firms based abroad, welcomes the new rules.

“We see it ... as a hopeful roadmap to foreign investors in terms of the types of information that needs to be supplied to CFIUS and the types of transactions that need to go before CFIUS,” she says.

Still, lawyers say more time is now spent on front-end due diligence, often to determine whether a filing should be made at all. This includes reaching out to the CFIUS agencies that might have concerns over a deal in a particular sector, as well as seeking opinions from legislators on Capitol Hill.

“We try to do that with any transaction of merit,” says Covington & Burling’s Plotkin.

In fact, many law firms are touting their CFIUS expertise. A brochure on the CFIUS practice at DLA Piper, for example, features former House Majority Leader Dick Armey—a Republican who specialized in matters of homeland security—as a lead member of its CFIUS team.

“There’s a much broader awareness in the venture [capital] community, especially, about this,” says Bingham McCutchen’s Gagnier. “A decent amount of my practice is really talking investors off the ledge.” ■

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