US

# Careful dealing

Managing US trade law risk should be high on the checklist for City firms advising on international deals. The US trade law regime can present some very tricky issues as Jeffrey L Snyder, Lorry B Halloway and Alan WH Gourley explain

Jeffrey L Snyder

London's role as a financial centre for international deals depends largely on the expertise of counsel in some of the leading City firms. Capable of shepherding complex deals from conception to completion, you depend on expert knowledge of financial solutions, structural approaches to complex combinations and even the management of troublesome regulatory regimes. Among the most demanding regulatory regimes is US trade law. This regime creates tricky and slippery issues in any international deal. Getting expert assistance will continue to be important.

A look at some of the recent spectacular deal debacles — from CNOOC to DP World — might suggest that it is impossible to manage the risks of US trade laws in international deals. While some number of deals, no matter how well conceived, have the potential to become a political circus (Washington is, after all, home to them), the vast majority of the deals present reasonable and manageable risks. The secret is to recognise the risks early and know the issues well. Treat them with the same vigour as tax or finance issues.

## WHAT ARE THE TRADE LAW RISKS?

### US unilateral sanctions

Under the Trading with the Enemy Act or the International Emergency Economic Powers Act, the US maintains unilateral embargoes on Cuba and Iran, among other countries, and Specially Designated Nationals. These controls on trade apply with equal force to transactions — US persons cannot engage in transactions with Iranian or Cuban interests. This prohibition loomed large in last year's contest for Basell, the Dutch chemicals company. By some reports Iran was the most attractive bidder financially, but US sanctions laws threatened important customer relationships. Iranian Government ownership of those assets would have blocked or limited transactions essential to the operations of the company.

The Iran and Libya Sanctions Act, or ILSA, another law targeted at Iran, authorises the US President to impose sanctions on non-US companies investing more than $20m (£10.6m) in Iran's petroleum sector. Acquisition targets with any activity in Iran carry sanctions risk. Companies scouting in this area have sought advice on the impact ILSA enforcement, should it occur as part of the US efforts to influence Iranian policy, would have on combined operations. Bets in this area are high stakes, particularly because ILSA contains an explicit successor liability provision.

**THE CLEAR LESSON IS NOT ONLY THAT TRADE RISK CAN IMPAIR DEALS, BUT MORE IMPORTANTLY, TRADE RISK CAN BE ANTICIPATED AND MANAGED**

### Arms export controls

Acquisitions in the defence industry present special concerns. Longer lead times and unpredictable agency processing create greater uncertainty. Less well known, however, is the impact that the International Traffic in Arms Regulations have on what might seem commercial items. The movement toward government procurement of commercial rather than specially designed items has expanded the number of companies in the US that are considered manufacturers of defence articles. For example, IT services, if provided to a defence agency under a development contract, could cause the supplier to be considered a manufacturer of defence articles, imposing registration, licensing and other hurdles. This would transform a simple supply arrangement in to a compliance headache.

### Dual-use/commercial export controls

Failure to anticipate the impact of export controls can delay or ruin deals, especially those driven by the need for access to technology. Immediate and complete freedom to exploit technology through global sharing within a corporation is a natural expectation. The export laws constrain that freedom because technology is 'deemed' exported when it is released to a non-US person, either in or out of the US. Value propositions, timing and structuring of deals, must often be revised or reconsidered to factor in the export laws. Imagine the impact of a scenario involving deemed reexports releases of US technology to non-UK nationals in the UK. How many buyers consider this consequence?

### Foreign Corrupt Practices Act (FCPA)

The halls of law firms in Washington are littered with the remnants of deals undone or regretted because of the US FCPA. The prosecution of Titan, and the impact on its acquisition by Lockheed, or the prosecution of Syncor, which affected the acquisition by Cardinal Health, are just a few of the high water marks in this area. The red hot focus on corruption and bribery of foreign officials

shows no sign of abating. Observers are watching how Lucent and Alcatel resolve the ongoing SEC investigation of Lucent involving China that Lucent disclosed in 2004 and the unrelated issues for Alcatel in Cost Rica as well.

### Committee on Foreign Investment in the US (CFIUS)

The fallout from DP World has not yet run its course. The demands for greater scrutiny of foreign acquisitions have drowned out the calls for rational consideration of true security risks. Until the dust settles on this issue, pure legal issues will take a back seat to political grandstanding. Whatever new rules govern the CFIUS, one thing is certain: acquisitions of US companies by foreign buyers are going to be subjected to greater levels of review. Deals that may have sailed through the process a year ago are now receiving extended CFIUS consideration.

### Customs

While importing has often been considered routine activity, it is anything but since 9/11. Deals have soured because the structure of the US operation, post acquisition, has not matched expectations. In one case, the seller could not use the price to its subsidiary as the import value, creating cost and cash flow issues and increased exposure to customs. In another case, the buyer failed to adequately secure the treatment of the goods under the North America Free Trade Agreement, jeopardising 20% of the revenue of the acquired company.

### Government contracts

Many acquisitions are driven by access to customers; when the US Government, one of the biggest buyers in any market, is the customer, special rules apply. Ensuring that the acquired company, as it is integrated into the new company, can continue to sell to the US Government, is a key requirement. Recent cases have disqualified goods sold to the Government because they contained raw materials from non-qualifying sources. The resulting 'false claims' (of US-origin) created a public relations disaster as well as a major revenue hit. Foreign ownership of US suppliers has come under scrutiny. In one case a European company was threatened with debarment because the Iranian Government owned a significant portion of its stock.

Naturally, there are other agency issues. The Food and Drug Administration, Environmental Protection Agency, the Federal Communications Commission, and many others, also have regulatory approvals that facilitate trade and present obstacles to many deals.

### Successor liability

An overarching consideration for buyers of US companies or others with business in the US is the concept of successor liability. While not unknown in corporate circles, a string of trade law cases — arms exports, commercial exports, customs, FCPA, and more — illustrate new tactics by US enforcement agencies, and send a clear signal to would-be buyers. These decisions impose the sins of the target on the buyer, forcing the buyers to 'police' the targets.

While few of the US trade laws contain specific successor liability provisions, at least one does — ILSA, described above. We have been called on a number of times to consider the operation of the ILSA successor liability provision, and while it is not a model of clarity, it has had a chilling effect on transactions.

MANY AQUISITIONS ARE DRIVEN BY ACCESS TO CUSTOMERS; WHEN THE US GOVERNMENT, ONE OF THE BIGGEST BUYERS IN ANY MARKET, IS THE CUSTOMER, SPECIAL RULES APPLY

### Managing the issues

Based on our experience with pitfalls in transactions described above or similar, the clear lesson is not only that trade risk can impair deals, but more importantly, trade risk can be anticipated and managed. Here are some of the steps to take:

**Step 1** Determine the extent of exposure to US trade risk. Early on in the pre-deal review, give trade laws greater prominence; do not treat compliance as a post-closing/integration issue. Identify what aspects of the target's business could create liability for the buyer under the trade laws.

**Step 2** Assess compliance. Go beyond traditional due diligence and include a review of compliance by the target. Assessing whether compliance measures are adequate to address the risks is becoming a pre-acquisition function.

**Step 3** Do not rely on representations and warranties. Relegating trade risk to a contractual issue is a thing of the past. Contracts cannot insulate the buyer from regulatory enforcement and while they can underwrite some costs, this strategy can bring buyer's remorse.

**Step 4** Force the seller to confront and resolve issues. The lesson of recent cases in the US — including Titan and others under the FCPA — is that buyers can demand that targets resolve any trade risk issues prior to the acquisition.

These tactics may well delay or revise the acquisition but they create greater certainty. They allow the new company to get on with integration and sales, which after all is the goal of the effort in the first place.

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